IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-1794

In the Matter of

THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY,

Debtor.

JACOB D. ZELDES, Successor Indenture Trustee Under the New York, New Haven and Hartford Railroad Company's General Income Mortgage Dated as of July 1, 1947,

Petitioner,

—v.—

MANUFACTURERS HANOVER TRUST COMPANY, Former Indenture Trustee Under the New York, New Haven and Hartford Railroad Company's First and Refunding Mortgage Dated as of July 1, 1947; and

RICHARD JOYCE SMITH, Trustee of the Property of the New York, New Haven and Hartford Railroad Company, Debtor,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JACOB D. ZELDES
ELAINE S. AMENDOLA
Zeldes, Needle & Cooper
A Professional Corporation
P.O. Box 1740
Bridgeport, Connecticut 06601
Counsel for Jacob D. Zeldes, Petitioner

June 15, 1977

INDEX

TABLE OF AUTHORITIES

Cases:

IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. .....

In the Matter of

THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY,

Debtor.

JACOB D. ZELDES, Successor Indenture Trustee Under the New York, New Haven and Hartford Railroad Company's General Income Mortgage Dated as of July 1, 1947,

Petitioner,

—v.—

MANUFACTURERS HANOVER TRUST COMPANY, Former Indenture Trustee Under the New York, New Haven and Hartford Railroad Company's First and Refunding Mortgage Dated as of July 1, 1947; and

RICHARD JOYCE SMITH, Trustee of the Property of the New York, New Haven and Hartford Railroad Company, Debtor,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Opinions Below

The United States Court of Appeals for the Second Circuit (the "Court of Appeals")[1] rendered its decision March 18, 1977. The decision has not yet been reported, and it is reproduced in the appendix to this petition (1a).[2] The opinion of the Reorganization Court is reported at 421 F. Supp. 249 (Conn. 1976), the relevant portions of which are reproduced in the appendix to this petition (39a).

Jurisdiction

The Court of Appeals' decision is dated March 18, 1977. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1), 28 U.S.C. 2101 (c) and Rule 19 of the Rules of this Court.

---

[1] Other frequently used contracted forms of reference herein are:
The New York, New Haven and Hartford Railroad Company, Debtor, is referred to as "New Haven."
The Penn Central Transportation Company, Debtor, is referred to as "Penn Central."
The United States District Court for the District of Connecticut is referred to as "reorganization court."
Manufacturers Hanover Trust Company and A. Frederick Keuthen together are referred to as "Manufacturers."
Simpson, Thacher and Bartlett is referred to as "Simpson Thacher."
Kelley, Drye, Newhall, Marginnes and Warren is referred to as "Kelley Drye."

[2] References to the numbered pages of the appendix to this petition are indicated (a).

Statute Primarily Involved

Section 77(c)(12) of the Bankruptcy Act, 11 U.S.C. §205(c)(12) (1970), in pertinent part provides:

> "Within such maximum limits as are fixed by the Commission, the judge may make an allowance, to be paid out of the debtor's estate, for the actual and reasonable expenses (including reasonable attorney's fees) incurred in connection with the proceedings and plan by parties in interest and by reorganization managers and committees or other representatives of creditors and stockholders, and within such limits may make an allowance to be paid out of the debtor's estate for the actual and reasonable expenses incurred in connection with the proceedings and plan and reasonable compensation for services in connection therewith by trustees under indentures, depositories and such assistants as the Commission with the approval of the judge may especially employ. . . ."

Question Presented

Whether a former indenture trustee under the mortgage of the debtor railroad, as a claimant under §77(c)(12) of the Bankruptcy Act, can recover payments for compensation, expenses and attorneys' fees from the debtor's estate against which it was and remains in conflict by actively pursuing interests adverse to the estate on the central issue of the reorganization.

Statement of the Case

The New Haven has been in reorganization under Section 77 of the Bankruptcy Act since July 7, 1961 and from that time Circuit Judge Robert P. Anderson, sitting by designation, has exercised jurisdiction over the reorganization of the New Haven. On June 30, 1976, the reorganization court rendered a decision which, *inter alia,* awarded payments of compensation and disbursement of expenses to Manufacturers, a former indenture trustee which the reorganization court had found acted in a conflict of interest, had hired two counsel who had taken directly conflicting positions on the central issue facing reorganization, had damaged the New Haven estate and was continuing to do so. 421 F. Supp. 249 (39a). At issue is that order awarding payment to Manufacturers which was affirmed by the Court of Appeals for the Second Circuit (1a). Petitioner is the successor indenture trustee under the New Haven's General Income Mortgage and respondents are Manufacturers and the New Haven Trustee, Richard Joyce Smith.

On December 31, 1968 the transportation plant of the New Haven was conveyed to Penn Central for a tentatively agreed upon price of approximately $125 million (5a). On June 29, 1970, in the *New Haven Inclusion Cases,* 399 U.S. 392 (1970), this Court determined the total consideration to be paid by Penn Central for the New Haven assets aggregated $174.6 million (6a).

On June 21, 1970, just eight days before this Court's decision in the *New Haven Inclusion Cases, supra,* Penn Central filed its petition for reorganization under Section 77 of the Bankruptcy Act. Although the price to be paid

for the New Haven assets was fixed, the New Haven estate still has not been paid by Penn Central (11a). The major efforts of the New Haven Trustee and other parties to the reorganization of the New Haven since 1968 have been directed at obtaining payment as a secured creditor from the Penn Central.

From the time of the filing of the Penn Central petition until this time, Manufacturers, through separate counsel, has been in conflict with and has acted against the interests of the New Haven estate, from which it sought and was awarded payment for compensation and expenses. Manufacturers, in the precise words of the reorganization court judge who has supervised this proceeding since its inception 16 years ago

> *"has 'pursued [an] interest adverse to the New Haven estate'* in pursuing the interests of the 18 New York Central and/or Pennsylvania Railroad indentures . . .
>
> ". . . *it is clear* that the *breach of fiduciary duty by Manufacturers Hanover* to the New Haven's first mortgage bondholders has *impeded, and therefore damaged,* the New Haven reorganization trustee's collection of the sums owed the New Haven estate from the Penn Central for the transferred properties of the New Haven and has *frustrated* the further development of a plan of reorganization for the New Haven . . . " 421 F. Supp. at 266 (47a-48a). (Emphasis added.)

The source of the conflict was stated by the Court of Appeals:

> "On the one hand, it was the indenture trustee under the first and refunding mortgage of the New Haven; and, on the other hand, it was a creditor of the Penn

Central and trustee under mortgages of the New York Central" (7a). (Footnotes omitted.)

The nature of the conflict was explained more accurately by the reorganization court:

"'. . . In August, 1970 the New Haven reorganization court called for statements of position by the parties in interest relative to the remand ordered by the Supreme Court in the *Inclusion Cases*. There arose at that time an important issue in which the Manufacturers, as indenture trustee for the New Haven's First and Refunding Mortgage and represented by the Simpson, Thacher firm of attorneys, was sharply at odds with the Manufacturers, as indenture trustee of the New York Central and Hudson River Railroad Company Gold Bond mortgage [in which capacity the same trust company was] represented by the Kelley, Drye firm of attorneys. On June 21, 1971 Manufacturers resigned as indenture trustee for the First and Refunding Mortgage of the New Haven. *As recently as July 21, 1975, the Manufacturers sought leave of the United States District Court for the Eastern District of Pennsylvania to resign as indenture trustee for New York Central and Hudson River Railroad Company Gold Bond mortgage dated June 1, 1897, because of potential conflict with its former position as indenture trustee for the New Haven mortgage. So far as is known, Manufacturers continues to act as indenture trustee for the 17 remaining mortgages.* . . .'

"The Manufacturers Hanover's petition to the Penn Central reorganization court to resign as indenture

trustee for the New York Central and Hudson River Railroad Company Gold Bond Mortgage, dated June 1, 1897, was granted by the Penn Central reorganization court. *It is undisputed that Manufacturers Hanover Trust Company is continuing to act as indenture trustee for each of the several bond issues of the New York Central and/or Pennsylvania Railroads which have interests contrary to those of the estate of the New Haven Railroad in reorganization.* Moreover, the Manufacturers Hanover Trust Company, as indenture trustee of the New York Central and/or Pennsylvania Railroad bond issues, is of the opinion that it still has a duty to assert, on behalf of the bondholders of those issues, claims contrary to the interests of the New Haven estate, so long as it is in the interests of and the desire of the New York Central and/or Pennsylvania Railroad bondholders to do so." 421 F. Supp. at 263-264 (41a-42a). (Emphasis added.)

The importance of the conflict, which, as found by the reorganization court, Manufacturers faced since Penn Central filed its petition for reorganization on June 21, 1970, 421 F. Supp. at 264 (42a), was realized when the controversy arose as to how to secure the $174.6 million due the New Haven from the Penn Central. The New Haven trustee's position that the reorganization court should declare the existence, since December 31, 1968, of an equitable lien and constructive trust was supported by Manufacturers through Simpson Thacher. At the same time, however, Penn Central's opposition to the security devices was supported by Manufacturers through Kelley Drye. As Judge Anderson said:

"The startling result was that, on opening court one morning, the New Haven reorganization court was handed a brief by the Simpson, Thacher firm from Manufacturers Hanover Trust Company for the New Haven side of the case, and it was then handed another brief by the Kelley, Drye firm from the Manufacturers Hanover Trust Company for the other side of the same case." 421 F. Supp. at 265 (46a).

The reorganization court's decision imposing the equitable lien and constructive trust in favor of the New Haven estate issued on June 11, 1971. *In re N.Y., N.H. & H. R.R. Co.*, 330 F. Supp. 131 (Conn. 1971). Acting through the Kelley Drye firm, Manufacturers, together with the Penn Central Trustees, appealed to the Court of Appeals for the Second Circuit, and as the reorganization court stated, the conflict

"was dramatized by the successful action which Manufacturers Hanover, as indenture trustee for the Gold Bonds, brought, through the attorneys for its trust department, Kelley, Drye, Warren, Clark, Carr & Ellis, against the New Haven reorganization trustee on the ground that the New Haven reorganization court lacked jurisdiction, on remand of the Inclusion Cases by the Supreme Court, to pass upon the secured status of the New Haven's claim for payment for the New Haven's sale and transfer of its operating property.' [457 F.2d 683 (2 Cir.), *cert. denied*, 409 U.S. 890 (1972)]." 421 F. Supp. at 264 (43a).

The record simply does not support the factual assertions of the Court of Appeals that

"[i]n July 1970 Manufacturers undertook to extricate itself from this conflict of interests. It informed both the New Haven and the Penn Central reorganization courts, as well as the various trustees and their counsel, of the situation" (8a).

". . . Manufacturers made every possible effort to extricate itself" (28a).

". . . it is clear that the court was aware of the conflict . . ." (29a).

The evidence is precisely to the contrary and the reorganization court so found.

Manufacturers, as the reorganization court stated, "should have resigned from both" estates immediately as its Chairman of the Board had directed. 421 F. Supp. at 265 (46a, 59a-60a). Instead, Manufacturers—as the testimony of Robert A. Byrne, the Vice President and only witness whom Manufacturers presented to justify its petition for payment indicated—attempted to insulate itself from its conflicts problems by maintaining separate counsel for its conflicting interests: Simpson Thacher to represent its New Haven interests and Kelley Drye to represent its Penn Central interests. 421 F. Supp. at 265 (46a, 59a, 62a-63a).

As to Manufacturers' insulation theory, it was developed on the advice of counsel from both Simpson Thacher and Kelley Drye (62a-63a). The two sets of lawyers, moreover, reported to the same officials at Manufacturers (62a). The insulation theory was approved neither by the New Haven reorganization court nor by the Penn Central reorganization court (62a). The record is absolutely clear, moreover, that Manufacturers never informed nor petitioned either the New Haven reorganization court or the Penn Central

reorganization court with regard to the appointment of a guardian ad litem, substitute trustees, or, for that matter, any advice or instructions concerning its conflicting situation (60a-61a). The evidence is undisputed that the conflicts issue was never taken up with the New Haven reorganization court at all (61a).[3] For obvious reasons, Manufacturers never claimed to the New Haven reorganization court that it had advised that court of its conflicting interests.

As to Manufacturers making "every possible effort to extricate itself" from the conflicts, the reorganization court specifically found:

> "The Trust Company, as indenture trustee for the New York Central and/or Pennsylvania Railroad indentures did speak of resigning but was dissuaded from

[3] Manufacturers did indeed argue in the Court of Appeals that in July, 1970, it had advised both the New Haven and the Penn Central reorganization courts of its conflicts. However, as noted, the record in these lengthy proceedings is wholly devoid of anything to support either Manufacturers' claim or the statement by the Court of Appeals that Manufacturers had "informed both the New Haven and the Penn Central reorganization courts" of its conflicts (8a). To support this statement, the Court of Appeals apparently relied on a claim of counsel in the reply brief which Manufacturers had filed in the New Haven reorganization court in support of its petition for compensation. In that reply brief Simpson Thacher referred to Kelly Drye's petition to intervene in the Penn Central reorganization—a document which is not in this record and which hardly informed the New Haven reorganization court of the conflict. With respect to informing the New Haven reorganization court, Manufacturers, in the Court of Appeals referred solely to counsel's affidavit in support of Manufacturers' petition for compensation dated June 12, 1975, almost five years after the conflict arose. That affidavit merely notes some informal discussion among various counsel concerning the conflict, and, in any event, is wholly inconsistent with the only testimony produced by Manufacturers in support of its petition:

> "The Court: You didn't take the issue up with the Court at all?
>
> "The Witness: No" (61a).

> doing so. *It never took a strong stand for that proposition and never, when contemplating its dilemma, refused to serve, following this stand by pressing for or seeking an authoritative court declaration of its rights and duties, as it should have done.*" 421 F. Supp. at 266 (48a). (Emphasis added.)

> "The petitioner plainly breached its fiduciary duty to the New Haven Railroad in reorganization and for five years has continued to do so. It has expressly stated its intention to adhere to this position in the future and to oppose and contest the claim of the New Haven estate in reorganization that the purchase price due for the New Haven's property, based upon the Supreme Court's judgment against the Penn Central in the *Inclusion Cases,* is secured by an equitable lien. For the past three years, at least, *the petitioner has made no genuine effort to resign as Indenture Trustees for the remaining 17 bond issues for which it is still Indenture Trustee.*" 421 F. Supp. at 274 (57a). (Emphasis added.)

Moreover, the Court of Appeals stated that there was no support for petitioner's "assertion that the court would have ordered Manufacturers to resign if it had petitioned the court for instructions" (28a). But Judge Anderson had stated:

> "Manufacturers Hanover should have resigned from both, as its Chairman had said, but apparently no one felt the necessity of following through on his admonition." 421 F. Supp. at 265 (46a).

A petition for instructions or an attempt to resign, according to the Court of Appeals "would have been futile"

(30a) since "Manufacturers was in a complete bind" (29a). But the reorganization court considered the practical difficulties facing Manufacturers and concluded:

> "Nevertheless the prospect of more problems superimposed upon already existing ones of immense difficulty cannot operate to condone a breach of fiduciary duty or justify it." 421 F. Supp. at 265 (45a).

In passing on Manufacturers' claim,[4] the reorganization court allowed Manufacturers' expenses of $103,018.34 and treated its direct compensation request for $304,416.67 on a contingent basis due to its conflict, ruling that Manufacturers could recover one-quarter (¼) of one per cent (1%) of payments made to the New Haven by Penn Central for the purchase of the New Haven properties, but not to exceed the claimed $304,416.67. 421 F. Supp. at 267 (49a-50a).

Although he recognized that the prime authority on allowances, *Woods* v. *City National Bank and Trust Co.*, 312 U.S. 262 (1941), "authorized a complete disallowance

[4] Manufacturers' claim, incurred from July 7, 1961 to August 30, 1971, was as follows:

1. Compensation to Manufacturers	$ 304,416.67		
2. Expenses of Manufacturers	103,018.34		
		$ 407,435.01	
3. Legal fees of Simpson, Thacher and Bartlett	$ 107,000.00		
4. Disbursements of Simpson, Thacher and Bartlett	15,234.81		
		1,715,234.81	
		$2,122,669.82	

of fees for services and reimbursement of expenses . . ." 421 F. Supp. at 266 (49a), Judge Anderson isolated Manufacturers' claim as to Simpson Thacher from its direct claim and awarded Simpson Thacher's disbursements of $15,234.81 and legal fees of $808,000, plus such contingent addition as may later eventuate in accordance with a provision not relevant to the issues raised by this petition.[5]

It is against this background that the Court of Appeals upheld the definite award of $926,253.15 and the potential award of $1,535,568.83 out of the New Haven estate to Manufacturers while it continues to occupy fiduciary positions in conflict with the New Haven estate on the central issue involved in the reorganization. Petitioner urges this Court to grant *certiorari* and seeks reversal of the judgment below affirming the reorganization court's order, insofar as it awarded any compensation or reimbursement of expenses at all to Manufacturers.

[5] The total definite award to Manufacturers is:

1. Expenses of Manufacturers	$ 103,018.34		
2. Legal fees of Simpson, Thacher and Bartlett	808,000.00		
3. Expenses for Simpson, Thacher and Bartlett	15,234.81		
		Definite Award	$ 926,253.15
which potentially can be increased by the contingency factor as follows:			
4. Contingency to Manufacturers	$ 304,416.67		
5. Contingency to Simpson, Thacher and Bartlett	304,899.01		
		Contingent Award	$ 609,315.68
		Total Award	$1,535,568.83

REASONS FOR GRANTING THE WRIT

Summary

This Court should grant *certiorari* because this case involves fundamental equitable principles governing the conduct of fiduciaries in bankruptcy reorganizations and the decision of the Court of Appeals stands in blatant defiance of this Court's decisions establishing a strict rule of denying compensation and expenses to a fiduciary which has breached its duty by serving interests in the reorganization conflicting with those of its *cestui*. This most recent departure by the Second Circuit from this Court's long standing principles of equity is the culmination of a line of cases emanating from the Second Circuit, which have gradually eroded the inflexible rule of equity demanding undivided loyalty of fiduciaries established by this Court in *Woods* v. *City National Bank & Trust Co.*, 312 U.S. 262 (1941).

This case also highlights the need for this Court's clarification of the standards governing fiduciaries promulgated in *Woods* because, unlike the Second Circuit, other circuit courts have followed *Woods* strictly. Only this Court can resolve the conflict among the lower federal courts.

Although petitioner maintains that the question presented is controlled by *Woods*, as noted by the Court of Appeals (16a), the effect of a conflict of interest on an application for compensation under §77(c)(12) in a railroad reorganization is one of first impression, and petitioner maintains that it should be settled by this Court.

If the Court of Appeals decision is allowed to stand, it will set dangerous precedent for railroad reorganizations and all bankruptcy law, in that it allows a fiduciary to receive compensation from a debtor's estate against which it was and remains in conflict by actively pursuing interests adverse to the estate. The decision will have broader detrimental effects, not limited to the rights of bond holders in railroad reorganizations, for it is replete with justifications for undermining established guidelines governing the conduct of fiduciaries in the law of trusts.

Finally, the decision of the Court of Appeals consists merely of declinations which offer no standards by which district courts may implement its flexible approach to judge the conduct of fiduciaries.

I.

While it continues to occupy fiduciairy positions in conflict with the New Haven estate on an issue at the heart of the New Haven reorganization, Manufacturers has been awarded a direct payment of $926,253.15 plus a contingent payment of up to $609,315.68 as an indenture trustee of the New Haven estate. The action of the Court of Appeals can only encourage Manufacturers to maintain its hostile position advanced as a fiduciary in the Penn Central reorganization and attempt to thwart the New Haven's effort to collect the $121,959,605.02 balance due from Penn Central, so as to virtually eliminate the New Haven's ability to honor its obligations to its bondholders.

Although recognizing that Manufacturers "had, and continues to have, a conflict of interest" (14a), "that such conduct constituted a breach of fiduciary duty under *Woods* v. *City National Bank and Trust Co.*, 312 U.S. 262 (1941); and, that such breach 'impeded, and therefore damaged,

the New Haven reorganization trustee's collection of the sums owed the New Haven estate . . . and has frustrated the further development of a plan for the New Haven . . .'" (13a), the Court of Appeals refused to follow the equitable principles established by this Court in *Woods* on the ground that to do so "would render equity inequitable" (15a, 21a).

Adopting a strict rule in order to foreclose the "tendency to evil" implicit in such cases, 312 U.S. at 268, this Court held that neither the indenture trustee—a fiduciary serving interests conflicting with those of his cestui—nor his counsel was entitled to receive compensation for his services, regardless of his good faith. 312 U.S. at 270.

> 1. "'[R]easonable compensation for services rendered' necessarily implies *loyal and disinterested service in the interest of those for whom the claimant purported to act.*" 312 U.S. at 268. (Emphasis added.)
>
> 2. *"Where a claimant who represented members of the investing public, was serving more than one master or was subject to conflicting interests, he should be denied compensation.* It is no answer to say that fraud or unfairness were not shown to have resulted. . . . *'What is struck at in the refusal to enforce contracts of this kind is not only actual evil results but their tendency to evil in other cases.'* Weil v. Neary, 278 U.S. 160, 173. Furthermore, the *incidence of a particular conflict of interest can seldom be measured with any degree of certainty.*" 312 U.S. at 268. (Emphasis added.)
>
> 3. "Where an actual conflict of interest exists, *no more need be shown* in this type of case to support a denial of compensation." 312 U.S. at 268. (Emphasis added.)

> 4. "A fiduciary who represents security holders in a reorganization may not perfect his claim to compensation *by insisting that although he had conflicting interests, he served his several masters equally well or that his primary loyalty was not weakened by the pull of his secondary one.*" 312 U.S. at 269. (Emphasis added.)
>
> 5. "Only *strict* adherence to these equitable principles can keep the standard of conduct for fiduciaries 'at a level higher than that trodden by the crowd.'" 312 U.S. at 269. (Emphasis added.)

In the case at bar, Manufacturers is not "disinterested," serves "more than one master," and has an "actual conflict of interest." Certainly "no more need be shown" than is on this record to revoke the award made to Manufacturers by the reorganization court for its own compensation, its attorneys' compensation and its expenses.

The Court of Appeals has interpreted *Woods* as merely recognizing "the inherent discretionary *power* of a reorganization court to disallow compensation and expenses on the ground of conflict of interest" (16a). But the *Woods* opinion never once mentions "flexibility" or "discretionary power" to reach its holding denying compensation, but rather adopts a prophylactic rule specifically stating that a fiduciary serving conflicting interests "should be denied compensation." 312 U.S. at 268.

The inflexibility of the *Woods* rule regarding compensation is manifest from this Court's relaxation of the rule to allow discretion solely with respect to the reimbursement of the fiduciary's costs and expenses. As this Court noted,

"The *rule* disallowing compensation because of conflicting interests *may* be equally effective, to bar recovery of the expenditures made by a claimant subject to conflicting interests. Plainly, expenditures are not 'proper' within the meaning of the Act where the claimant cannot show that they were made in furtherance of a project exclusively devoted to the interests of those whom the claimant purported to represent. . . . Such classification of expenses, at times difficult, rests in the sound *discretion* of the bankruptcy court." 312 U.S. at 269-270. (Emphasis added.)

The fundamental principles of equity, proclaimed in *Woods*, were forthrightly reaffirmed by this Court in a related context applying §249 of the Bankruptcy Act:

"Moreover, it is well settled that when the question arises in a terminal application for *compensation or reimbursement* under §247, an applicant who has engaged in forbidden transactions near the end of the proceeding is to be denied compensation for all services he has rendered to the Debtor, however valuable those services may have been." *Wolf* v. *Weinstein*, 372 U.S. 633, 654 (1963).

The Court of Appeals took great pains to undermine the importance of *Wolf*, claiming it dealt only with "a specific statutory rule" (23a), and holding "§249 and *Wolf* are inapplicable" (24).[6]

[6] *Wolf*, ironically, reversed the Second Circuit which had found that §249 did not embrace certain officers and employees and had held, as it did here, that the issue of compensation should rest upon the exercise of judicial discretion rather than the automatic forfeiture which §249 required. *Nazareth Fairgrounds and Farmers Market, Inc.* v. *Wolf*, 296 F.2d 678 (2 Cir. 1961).

But, as this Court explained in *Wolf*, the Congressional purpose behind §249 was "to codify the rule" of federal decisions denying compensation to persons holding fiduciary positions in reorganization proceedings who had traded in the debtor's stock and "to give pervasive effect in Chapter X proceedings to the *historic maxim of equity* that a fiduciary *may not* receive compensation for services tainted by disloyalty or conflict of interest." 372 U.S. at 641 (Emphasis added). This Court in *Wolf*, therefore, considered the admittedly harsh provisions of §249 to be reflective of the equitable principles announced in *Woods*, explaining,

"The rationale underlying the denial of compensation and expenses is that allowances may be made, under general equitable limitations and the statutory provisions alike, only for 'loyal and disinterested service in the interest of those for whom the claimant purported to act.' *Woods* v. *City Nat. Bank & T. Co.*, *supra* (312 U.S. at 268). Section 249 does no more than declare that one who invests in the Debtor's stock during a reorganization ceases to be disinterested for purposes of compensation and allowances." 372 U.S. at 653 n. 20.

Notwithstanding recognition of the *Woods* rule that "the law does not countenance such activity by a fiduciary—even an indenture trustee," 421 F.Supp. at 266 (47a), the reorganization court—presided over by "a wise and comprehending chancellor" (3a), a characterization by the Court of Appeals with which petitioner agrees—felt bound by the decisions in *Berner* v. *Equitable Office Building Corp.*, 175 F.2d 213 (2 Cir. 1949), and *Silbiger* v. *Prudence Bonds Corp.*, 180 F.2d 917 (2 Cir.), *cert. denied*, 340 U.S.

813 (1950), which in the Second Circuit, at least, "tempered" the strict rule of *Woods,* 421 F.Supp. at 266 (49a). These two Second Circuit cases,[7] and now the decision below, which repeatedly resorts to the concept of "flexibility" (16a, 19a, 21a) for its professed equitable foundation, have seriously diluted this Court's "inflexible rule of denying compensation to creditors' representatives serving conflicting interests" established in *Woods.* See note, *Denial of Compensation to Bondholders' Representatives Serving Conflicting Interests in Corporate Reorganization,* 50 Yale L.J. 1492, 1493 (1941).[8]

Berner, the apparent source of the Second Circuit's "flexible," "discretionary" or "less harsh" approach to compensating fiduciaries representing adverse interests, conflicting, as it does, with this Court's decisions in *Woods* and *Wolf,* has not been followed by the majority of federal courts and has been termed "peculiar to the Second Circuit." Note, *supra,* 106 U. Pa. L. Rev., 1155, 1156.[9]

---

[7] One other case, *Chicago & West Towns Rys* v. *Friedman,* 230 F.2d 364 (7 Cir.), *cert. denied* 351 U.S. 943 (1956), was referred to below; but, as noted by the Court of Appeals, it merely cited *Berner* and *Silbiger* to support its "penalty of less than full forfeiture" 230 F.2d at 369 (21a).

[8] Another authority, cited by this Court in *Wolf* v. *Weinstein,* 372 U.S. 633, 642 n. 10, regards *Woods* as "adopting a *strict* rule . . . that a fiduciary serving interests conflicting with those of his cestuis *may* receive reimbursement for proper expenditures but *may not* receive compensation for services regardless of his good faith." Note, *Conflict of Interests as a Factor in the Allowance of Representatives Claims in Insolvent Corporate Reorganizations,* 106 *U. Pa. L. Rev.* 1139, 1143 (1958).

[9] For another authority criticizing the Second Circuit's decision in *Berner,* see Note, *Bankruptcy—Corporate Reorganization—Trustee has Burden of Proving Under §249 that Stockholder's Attorney Seeking Compensation Acquired Interest in Debtor's Stock* 63 Harv. L. Rev. 1056 (1950).

Comparing *Silbiger,*[10] so heavily relied on by the Second Circuit below, to this Court's decision in *Woods,* one commentator has noted:

> "The *Woods* case seemed to establish an acceptable and desirable sanction for the control of committee conduct in corporate reorganization proceedings; however, it was apparently ignored by Judge Learned Hand in deciding *Silbiger* v. *Prudence Bonds Corp.*
>
> ". . . [I]t is submitted that, because of the underlying theory of the Supreme Court in the former case, the two cases reach opposite results. The *Woods* case, in establishing a prophylactic rule, seems to compel complete denial so long as the relationship of dual representation of persons with adverse interests is present. Neither the good faith of the representative in entering into the proceeding nor any beneficial results which might have accrued as a result of his participation are considered by the court under this theory.
>
> ". . .

A recent California case, *In re Walchef Development Corporation,* 388 F. Supp. 1064, 1070 (S.D.Cal. 1975), applying the unrelenting rule of *Wolf* to a §249 case, significantly relied heavily on the District Court opinion in *Berner, In re Equitable Office Building Corp.,* 83 F. Supp. 531 (S.D.N.Y. 1949), which the Second Circuit had reversed.

[10] In *Silbiger,* as noted by the Court of Appeals below (20a-21a), since the award was paid from the bond series which was fully compensated in the reorganization, the court considered that the attorney's allowance should only be reduced, not denied. In the case at bar, it cannot be said that payment to Manufacturers will come in no part out of any group that can be prejudiced, since the payment will necessarily diminish the funds available to meet the New Haven estate's obligations to the holders of its general income bonds, whom petitioner represents, and may diminish the payment to its first mortgage bondholders.

"It would seem that, assuming some sanction is desirable to prevent the representation of conflicting interests in reorganization proceedings, the *Woods* case reaches the better result." Note, *supra*, 106 U. of Pa. L. Rev. at 1144-1147.

Courts of Appeals in circuits, other than the Second, have applied the mandate of *Woods* strictly to deny compensation to fiduciaries with conflicting interests. The Tenth Circuit has held:

"In view of the crucial finding that within the time covered by the claim, the claimant represented interests which were in conflict with those of the debtor, the claim was not payable out of the bankruptcy estate. Woods v. City National Bank & Trust Co., supra." *Carey* v. *Selected Investments Corp.*, 319 F.2d 578, 581 (10 Cir. 1963).

The Sixth Circuit applied *Woods* strictly to bar compensation to a fiduciary representing conflicting interests "for his own time, or for fees to counsel or out-of-pocket expenses," stating he "gambled at his own risk. The gamble failed and he must foot the bill." *Young* v. *Potts*, 161 F.2d 597, 600 (6 Cir. 1947). Such reasoning seems especially applicable to Manufacturers' situation. Highlighting the split of authority, the Second Circuit has expressly refused to follow what it termed the "punitive rule" of *Potts*. *Certain Tweed Products Corp.* v. *Topping*, 171 F.2d 241, 243 (2 Cir. 1948).

The Third Circuit has held that the strict principles set forth in *Woods* barred compensation to an attorney who had traded in the shares of the debtor's subsidiary, independent of §249. *In re Midland United Co.*, 159 F.2d 340, 346 (3 Cir. 1947). See also *In re Philadelphia & W. Ry. Co.*, 73 F.Supp. 169 (E.D.Pa 1947).

Although the command of *Woods* seems unambiguous, the conflicting interpretations of Woods among the circuits relating to the proper sanction to be imposed upon fiduciaries representing conflicting interests calls for ultimate clarification by this Court. Note, *supra*, 106 U. Pa. L. Rev. at 1147.[11]

In its effort to avoid the impact of *Wood's* strict rule, the Court of Appeals attempts to distinguish Manufacturers' conflict of interest as "involuntary" (28a). Relying on a "basic tenet of trust law" that the "element of voluntariness is critical" to establishing a breach of trust, the Court of Appeals overlooks the findings of the reorganization court that Manufacturers "plainly breached its fiduciary duty to the New Haven Railroad and for five years has continued to do so," 421 F.Supp. at 274 (57a). Once the Penn Central defaulted, Manufacturers voluntarily maintained its conflicting interests in both estates in spite of its Chairman's direction to resign immediately from all indentures. 421 F.Supp. at 265 (46a, 28a, 59a). Once the conflict has been found, voluntariness is no longer a criterion for measuring the sanction for the breach under the *Woods-Wolf* doctrine.

Recognizing that Manufacturers' "breach concededly affected the whole trust property and occasioned a loss" (31a n. 26), the Court of Appeals nevertheless speaks of

[11] Since it found no breach of duty, the court in *In re Food Town, Inc.*, 208 F. Supp. 139, 147 n. 4 (Md. 1962), found it "unnecessary to attempt to reconcile the conflicting views" presented by such cases as *inter alia*, *Woods*, *Berner*, and *Silbiger*.

"the undisputed value of the services of the fiduciary and its counsel" (15a, 31a), thereby ignoring the *Woods* principle that "a fiduciary . . . may not perfect his claim to compensation by insisting that although he had conflicting interests, he served his several masters well or that his primary loyalty was not weakened by the pull of his secondary one." 312 U.S. at 269. In any event, Simpson Thacher's efforts to enhance the value of the New Haven estate were met by Kelley Drye's efforts to diminish its value. The inevitable consequence of Manufacturers' serious conflict of interest is that what its right hand—New Haven counsel—was giving, its left hand—Penn Central counsel—was and still is taking away.

The position which petitioner urges is that a claimant, such as Manufacturers, cannot be in a position of damaging the estate and impeding the reorganization, as it clearly is, while at the same time receiving from the debtor's estate payment for compensation or expenses, even if such services and expenses, for which payment was sought and made, in themselves did not cause the damage. Moreover, the ultimate price to be received by the New Haven from Penn Central is still very much in doubt.

It is of no moment, moreover, that many of the services were performed before the conflict became ripe. Since Manufacturers does not qualify as a fiduciary which has rendered only loyal and disinterested service, it must be denied compensation and reimbursement

> "for all services [it] has rendered to the Debtor, however valuable those services may have been . . . since the start of the reorganization." 372 U.S. at 654.

II.

As to the payment to Manufacturers for its attorneys, the Court of Appeals' decision permitting this award to stand establishes a rule of law, that a fiduciary—tainted by conflict—can recover attorneys' fees even after hiring separate attorneys to advocate diametrically opposed positions on the issue most seriously affecting the reorganization. Such a rule runs afoul of this Court's precedent, not only in *Woods,* which denied compensation to the attorney for the tainted indenture trustee, but also in *Wolf* which set forth the stronger rule that proof of a conflict by a fiduciary

> "forfeits any claim to reimbursement for expenses incurred by the applicant in connection with the proceeding." 372 U.S. at 653 n. 20.

In *Mosser* v. *Darrow,* 341 U.S. 267 (1951), once again, this Court proclaimed:

> "Equity tolerates in bankruptcy trustees no interest adverse to the trust. This is not because such interests are always corrupt but because they are always corrupting . . .
>
> "These strict prohibitions would serve little purpose if the trustee were free to authorize others to do what he is forbidden . . . We think that which the trustee had no right to do he had no right to authorize, and that the transactions were as forbidden for benefit of others as they would have been on behalf of the trustee herself." 341 U.S. at 271-272.

The *Mosser* case is analogous to Manufacturers' situation. Manufacturers hired two counsel to represent its conflict-

ing interests. That which Manufacturers "had no right to do," it "had no right to authorize," and if in doubt about its duty to its *cestui,* it should have sought instructions from the reorganization court, as the *Mosser* court advised. 341 U.S. at 274. The trustee in *Mosser* made "an honest mistake," 341 U.S. at 276 (Black, J., dissenting), and the trust estate profited. Yet this Court held him personally liable for the profits which his employees made.

The principle that equity will not allow compensation from the estate for services rendered on behalf of the indenture trustee to attorneys, who are not themselves in conflict but who nevertheless serve an indenture trustee with interests in conflict with its bondholders, was applied in *In re Ritz Carlton Restaurant & Hotel Co. of Atlantic City,* 60 F.Supp. 861 (N.J. 1945). The court there invoked the inflexible rule derived from *Woods*: that there can be no recovery of attorneys' fees for fiduciaries who do not possess the independence necessary for their duties.

The reasoning of the Court of Appeals that Simpson Thacher was guilty of no improper conduct since it was not tainted by Manufacturers' conflict (35a n. 30, 37a), is similar to that proferred by counsel in *In re American Acoustics, Inc.,* 97 F.Supp. 586, 589 (N.J.), *affirmed,* 192 F.2d 81 (3 Cir. 1951) (*per curiam*), where the court nevertheless applied the "general principles" of *Wood* and *In re Ritz Carlton Restaurant Co., supra,* to invoke a strict rule denying compensation to attorneys who represented adverse interests.

The Sixth Circuit also invokes a rule of "strict enforcement . . . although often resulting in an obvious financial

hardship," *In re Inland Gas Corp.,* 309 F.2d 176, 181 (6 Cir. 1962), to deny reimbursement to a disqualified fiduciary of its counsel's out-of-pocket expenses.

The fallacy in the Court of Appeals' position justifying the award to Simpson Thacher is manifest from its statement that "Manufacturers did not authorize Simpson Thacher to pursue the conflicting interests that Manufacturers was forbidden to pursue" (36a). Obviously, it was not Simpson Thacher, but Kelley Drye whom Manufacturers authorized to pursue interests adverse to the New Haven estate, which conflicting interests are still being pursued. Moreover, the assertion that "the trustee and the attorneys self-consciously made sure that whatever taint infected the trustee would not infect the attorneys" (37a), is wholly untenable in light of the fact that counsel for both sets of bondholders, Simpson Thacher for the New Haven bondholders and Kelley Drye for the Penn Central bondholders, reported to the *same* officials at Manufacturers (62a). Control of counsel's actions in the New Haven reorganization as well as in the Penn Central reorganization rested with Manufacturers, which made the ultimate decisions with respect to the position taken by Manufacturers on both sides of the equitable lien issue. Under these circumstances, to attempt to evaluate the effect on the New Haven estate as a result of Manufacturers' conflicting interests, would indeed be an exercise in speculation, which *Woods* held the bankruptcy court need not do. 312 U.S. at 268.

Although both Manufacturers and the lawyers recognized the conflict, Counsel did not advise Manufacturers to resign from both estates, to seek instructions from the reorganization courts involved, or to ask for a guardian ad litem (60a-61a), even though the Chairman of the Board of

Manufacturers had directed that it resign immediately from all mortgages in both estates (59a). But Manufacturers on its own and with the advice of counsel chose its course of action—a course which the reorganization court found was improper.

The theory that representation on both sides of an issue insulates the fiduciary from liability for breach of a fiduciary obligation or protects the fiduciary and its attorneys from loss of compensation defies this Court's precedent and is dangerous policy. The issue of Simpson Thacher's fee boils down to whether the breaching fiduciary or his *cestui* and the estate should bear the expense of legal services rendered to the fiduciary. Petitioner urges that the fiduciary should bear the cost, and if the award is vacated, Manufacturers will pay Simpson Thacher (63a).

CONCLUSION

The danger of this decision by the Court of Appeals which attempts to justify its departure from this Court's strict equitable principles solely on "unusual circumstances" and "unique facts" (3a), seems to have been envisioned by Mr. Justice Cardozo writing for the New York Court of Appeals and quoted by this Court in *Woods*, 312 U.S. at 269:

> "Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd." *Meinhard* v. *Salmon, et al.*, 249 N.Y. 458, 164 N.E. 545, 546 (1928).

For these reasons, then, and to foreclose the "tendency to evil," 312 U.S. at 268, implicit in the judgment of the Court of Appeals awarding compensation and expenses to a fiduciary serving conflicting interests, this Petition for Writ of Certiorari should be—and petitioner respectfully requests that it be—granted.

Respectfully submitted,

JACOB D. ZELDES
ELAINE S. AMENDOLA

Zeldes, Needle & Cooper, P.C.
A Professional Corporation
P.O. Box 1740
Bridgeport, Connecticut 06601

Counsel for Jacob D. Zeldes,
Successor Indenture Trustee Under the New York, New Haven and Hartford Railroad Company's General Income Mortgage Dated as of July 1, 1947

INDEX TO APPENDIX

---

* In addition to being in the record on appeal, the entire transcript is printed in the joint appendix to the briefs of the parties in the Court of Appeals.

Opinion of the United States Court of Appeals for the Second Circuit

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 399, 725, 726—September Term, 1976.

(Argued January 6, 1976 Decided March 18, 1977.)

Docket Nos. 76-5025, 76-5033, 76-5037

IN THE MATTER OF THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, DEBTOR

LAWRENCE W. IANNOTTI, Successor Indenture Trustee Under The New York, New Haven And Hartford Railroad Company's First And Refunding Mortgage Dated As Of July 1, 1947; and

JACOB D. ZELDES, Successor Indenture Trustee Under The New York, New Haven And Hartford Railroad Company's General Income Mortgage Dated As Of July 1, 1947,

Appellants,

v.

MANUFACTURERS HANOVER TRUST COMPANY, Former Indenture Trustee Under The New York, New Haven And Hartford Railroad Company's First And Refunding Mortgage Dated As Of July 1, 1947; and

RICHARD JOYCE SMITH, Trustee Of The Property Of The New York, New Haven And Hartford Railroad Company, Debtor,

Appellees.

Before:

MOORE, OAKES and TIMBERS,

Circuit Judges.

Cross-appeals from so much of a judgment entered June 30, 1976 in the United States District Court for the District of Connecticut, Robert P. Anderson, *Circuit Judge,* sitting by designation, 421 F.Supp. 249 (D.Conn. 1976), as allowed compensation for services and expenses, including attorneys' fees, to a former indenture trustee, Manufacturers Hanover Trust Company.

Affirmed.

IRVING S. SCHLOSS, New Haven, Conn. (Lawrence W. Iannotti, and Tyler, Cooper, Grant, Bowerman & Keefe, on the brief), *for Appellant Iannotti.*

JACOB D. ZELDES, Bridgeport, Conn. (Elaine S. Amendola, and Zeldes, Needle & Cooper, on the brief), *for Appellant Zeldes.*

WHITNEY NORTH SEYMOUR, New York, N.Y. (Albert X. Bader, Jr., William K. Blomquist, Paul R. Gupta, and Simpson Thacher & Bartlett, on the brief), *for Appellee Manufacturers Hanover Trust Company.*

JAMES WILLIAM MOORE, New Haven, Conn., *for Appellee Richard Joyce Smith, Trustee of The New York, New Haven and Hartford Railroad Company, Debtor.*

TIMBERS, *Circuit Judge:*

This is the case of the wise and comprehending chancellor.

The case comes to us on cross-appeals by two successor indenture trustees from so much of a judgment of June 30, 1976, entered upon an opinion and order of the same date in the United States District Court for the District of Connecticut (the New Haven reorganization court), Robert P. Anderson, *Circuit Judge,* sitting by designation, 421 F. Supp. 249 (D. Conn. 1976), as allowed to a former indenture trustee, Manufacturers Hanover Trust Company, compensation in amount of $304,416.67 and expenses in amount of $103,018.34, and to its counsel, Simpson Thacher & Bartlett, attorneys fees in amount of $808,000 and expenses in amount of $15,234.81.

The essential questions presented are (1) whether the New Haven reorganization court as a court of equity had the authority, absent a specific statutory directive to the contrary, in the exercise of its discretion to allow or to deny compensation and expenses, including attorneys' fees, to an indenture trustee which concededly represented conflicting interests under very unusual circumstances; and (2) if so, whether the reorganization court exercised sound discretion in allowing the compensation and expenses in question. We hold that the reorganization court did have such authority; that on the unique facts of this case it did exercise its discretion soundly; and that it reached a fair and equitable result in allowing the compensation and expenses in question. We affirm.

I.

The conflict of interest that lies at the heart of this case arose out of the complexities of two mergers and two reorganizations. The companies involved, as now known,

are the Manufacturers Hanover Trust Company (Manufacturers); the New York, New Haven and Hartford Railroad Company (New Haven); and the Penn Central Transportation Company (Penn Central). A brief narrative of how these companies reached their present status is necessary to an understanding of the instant controversy.

On July 7, 1961 the New Haven filed its petition for reorganization under § 77 of the Bankruptcy Act, 11 U.S.C. § 205 (1970), in the United States District Court for the District of Connecticut. Since 1947 the Manufacturers Trust Company (Trust Company), a predecessor of the present Manufacturers, had been the corporate indenture trustee of the New Haven's first and refunding mortgage.[1] The Trust Company intervened in the New Haven reorganization through its general counsel, Simpson Thacher & Bartlett (Simpson Thacher), which had represented the Trust Company in its capacity as corporate indenture trustee since 1947. Judge Anderson, who in 1961 was Chief Judge of the District Court for the District of Connecticut, has presided over all proceedings in the New Haven reorganization continuously from their inception to date—a period of nearly 16 years.

On March 9, 1962 the Pennsylvania Railroad Company and the New York Central Railroad Company first proposed the merger that ultimately led to the organization of the Penn Central in February 1968. The New Haven reorganization trustees sought inclusion of the New Haven in the merged railroad, primarily under § 5(2) of the Interstate Commerce Act, 49 U.S.C. § 5(2)(1970), both by private negotiations with the merging railroads and by a petition filed with the Commission on June 26, 1962. The Commission approved the Penn Central merger on April

1 Until July 1971 there was also an individual trustee, A. Frederick Keuthen, an officer of the Trust Company.

6, 1966 on the condition that the merged railroad would purchase the New Haven's assets. An agreement (inclusion agreement) was reached on April 21, 1966, between the New Haven trustees and the Pennsylvania and New York Central railroads, to include the New Haven in the Pennsylvania/New York Central merger. The agreement provided that the Penn Central would acquire the major part of the New Haven's assets for a consideration consisting of cash, bonds, Penn Central stock, and the assumption of certain of the New Haven's obligations. See generally *New Haven Inclusion Cases*, 399 U.S. 392, 408-410 (1970). The New Haven trustees bound themselves to support the agreement and the fairness of the proposed purchase price of approximately $125,000,000 for the New Haven's assets. Unlike the New Haven trustees, however, representatives of the New Haven's bondholders remained free to seek a higher price.

On October 24, 1966 the New Haven reorganization court authorized presentation of the agreement to the Commission which approved the agreement on November 16, 1967. *Id.* at 411-12. A final price had not been determined at that time, but on December 24, 1968, as we later noted, "because of the precarious financial condition of the New Haven and the imminent termination of its rail service, the [New Haven reorganization court] approved the transfer of New Haven's assets to Penn Central, leaving the exact amount and form of consideration to be paid by Penn Central to be settled finally at a later date." *In re New York, N.H. & H.R.R.*, 457 F.2d 683, 685 (2 Cir.), *cert. denied*, 409 U.S. 890 (1972). The Commission ultimately set the purchase price for the New Haven's assets at about 140 million, having previously concluded that the $125 million purchase price agreed to by the Penn Central and

the New Haven trustees was "fair and equitable." [2] In the *New Haven Inclusion Cases, supra*, the Supreme Court held that the 140 million purchase price approved by the Commission was grossly inadequate and itself set the price at $174.6 million.[3]

On June 21, 1970, just eight days before the Supreme Court's decision in the *New Haven Inclusion Cases,* the Penn Central filed a petition for reorganization in the Eastern District of Pennsylvania. Penn Central securities became virtually worthless overnight. As we later observed, since Penn Central securities "were to [have] comprise[d] a significant portion of the payment to the New Haven estate, the Supreme Court remanded the case for '[f]urther proceedings before the Commission and the appropriate federal courts . . . to determine the form that Penn Central's consideration to New Haven should properly take and the status of the New Haven estate as a shareholder or creditor of Penn Central.' 399 U.S. at 489 . . . ." *In re New York, N.H. & H.R.R.,* 479 F.2d 8, 11-12 (2 Cir. 1973).

The inclusion of the New Haven's assets in the merged and later bankrupt Penn Central would not have resulted in the conflict of interest with which we are here concerned had there not been still another merger—a non-railroad one. Backing up for a moment, in September 1961, two months after the New Haven filed for reorganization but before any of the other developments described

2 It was only after New Haven's bondholders successfully challenged the Commission in two separate suits, *In re New York, N.H. & H.R.R.,* 289 F.Supp. 451 (D.Conn. 1968), and *New York, N.H. & H.R.R.* v. *United States,* 289 F.Supp. 418 (S.D.N.Y. 1968) (three-judge court), that the Commission held further hearings and announced a new valuation of $140 million.

3 The Supreme Court affirmed the reorganization court's valuation of the New Haven's assets. 399 U.S. 392 (1970); see generally *In re New York, N.H. & H.R.R.*, 479 F.2d 8, 11 (2 Cir. 1973).

above, Manufacturers Trust Company merged with The Hanover Bank (Hanover), to form the present Manufacturers Hanover Trust Company. Hanover had served as trustee under mortgages of the New York Central since 1897. When Hanover merged with the Trust Company, the merged bank's trust department inherited those mortgages. The law firm then known as Kelley, Drye, Newhall, Maginnes & Warren (Kelley, Drye), Hanover's counsel, continued to handle the legal work of the merged bank's corporate trust department. Since Simpson Thacher had represented the Trust Company as corporate indenture trustee of the New Haven's first and refunding mortgage since 1947, the firm continued to represent Manufacturers in that capacity

Manufacturer's position as trustee under mortgages of the New Haven and of the New York Central presented no conflicts problems prior to June 21, 1970. On that day, however, when the Penn Central filed for reorganization, Manufacturers found itself representing conflicting interests. On the one hand, it was the indenture trustee under the first and refunding mortgage of the New Haven; and, on the other hand, it was a creditor of the Penn Central[4] and trustee under mortgages of the New York Central.[5]

4 Manufacturers is one of several bank participants in a $300 million loan to Penn Central under a credit agreement dated April 1, 1969. It also is one of the banks that loaned $50 million to the Pennsylvania Company, a subsidiary of Penn Central, under a credit agreement dated March 21, 1970. It also is the holder of certain equipment obligations of Penn Central subsidiaries. See Petition of Manufacturers Hanover Trust Company and A. Frederick Keuthen, 12 New York, N.H. & H.R.R. Reorganization Proceedings 8721, 8722 (June 21, 1971).

5 Manufacturers was trustee under eighteen New York Central mortgages, including the New York Central & Hudson River Railroad Company Gold Bond mortgage which covers the Grand Central Terminal properties.

In July 1970 Manufacturers undertook to extricate itself from this conflict of interests. It informed both the New Haven and the Penn Central reorganization courts, as well as the various trustees and their counsel, of the situation.[6] It then began a comprehensive effort to find successor corporate trustees for the New Haven mortgage and the eighteen New York Central mortgages. Between July 1970 and June 1971 Manufacturers contacted at least sixty-two banks. Its search included every commercial bank east of the Mississippi that had a substantial trust department and did not have a conflict of interest (such as being a creditor of the Penn Central). On July 29, 1971, the New Haven reorganization court appointed the first of the present individual successor trustees, for the reason that, "[a]lthough the underlying mortgage itself specified that a successor trustee must be a qualified bank, the court . . . could not permit a valid trust to fail for lack of a trustee . . . ."[7] 421 F.Supp. at 264. Manufacturers had not included individuals in its search because of the terms of the mortgage.

---

6 In Kelley, Drye's petition to intervene in the Penn Central reorganization proceedings, one of its partners stated:

> "However the situation came about, we and Manufacturers have decided, I believe correctly, that its duty to the bondholders under these mortgages requires us to intervene in this proceeding as soon as we can, rather than leaving them unrepresented until (and if) separate trustees and counsel, unconnected with this reorganization, can be found for each trust."

7 The court on that date appointed Lawrence W. Iannotti, Esq., one of the appellants here, as successor indenture trustee under the New Haven's first and refunding mortgage. Later, in January 1972, the Chase Manhattan Bank, N.A., resigned as trustee under the New Haven's general income mortgage because it was a creditor of the Penn Central. The court appointed Jacob D. Zeldes, Esq., the other appellant here, as successor indenture trustee under that mortgage.

Manufacturers remains to this day as trustee under seventeen of the New York Central mortgages. It found a successor for, and resigned from, the Gold Bond mortgage trusteeship on September 4, 1975. 421 F.Supp. at 265.

Meanwhile, the potential conflict recognized by Manufacturers as of June 21, 1970 became an actual one very quickly. Following the Supreme Court's remand, the New Haven reorganization court entered an order with broad notice provisions to determine what should be done to protect the New Haven's creditors. This resulted in due course in the entry of an order on June 22, 1971 pursuant to which the court sought to give the New Haven estate secured-creditor status by declaring "an equitable lien . . . on all of the former assets transferred by the New Haven to Penn Central, exclusive of (a) rolling stock and (b) the New Haven's one-half interest in the excess income from the Grand Central [Terminal] properties" and, as to "the latter item of property . . . [by declaring] a constructive trust in favor of the New Haven estate." *In re New York, N.H. & H.R.R.*, 330 F.Supp. 131, 142 (D. Conn. 1971).

During the proceedings which resulted in the order of June 22, 1971, the New Haven's interests were supported by, among others, the New Haven's trustee and Manufacturers as the indenture trustee, Manufacturers being represented by Simpson Thacher. Interests which opposed imposition of an equitable lien or constructive trust included the Penn Central, represented by the Washington, D.C. law firm of Covington & Burling; and Manufacturers, as indenture trustee under the Gold Bond mortgage, represented by Kelley, Drye. Covington & Burling assumed the lead role in opposing imposition of the equitable lien and constructive trust. The incongruity of the situation nevertheless was apparent. As the court put it,

> "The startling result was that, on opening court one morning, the New Haven reorganization court was handed a brief by the Simpson, Thacher firm from Manufacturers Hanover Trust Company for the New Haven side of the case, and it was then handed an-

other brief by the Kelley, Drye firm from the Manufacturers Hanover Trust Company for the other side of the same case." 421 F.Supp. at 265.

Through Simpson Thacher, Manufacturers supported the New Haven trustee's position in favor of imposing an equitable lien and constructive trust. Through Kelley, Drye, Manufacturers took the position that the New Haven reorganization court lacked jurisdiction over the New Haven assets that had been conveyed to the Penn Central.

Shortly after the New Haven reorganization court's decision, referred to above, which imposed an equitable lien and a constructive trust in favor of the New Haven estate on the transferred assets, Manufacturers and Mr. Keuthen on June 22, 1971 filed their applications to resign from the New Haven's first and refunding mortgage trusteeship. On July 29 the court approved the resignations and appointed Mr. Iannotti as successor trustee.

Penn Central appealed to our Court from the order entered on June 22, 1971. This appeal resulted in our decision of March 17, 19 2 that the New Haven reorganization court lacked jurisdiction over the New Haven's assets which had been transferred to Penn Central. *In re New York, N. H. & H.R.R.*, 457 F.2d 683 (2 Cir.), *cert. denied*, 409 U.S. 890 (1972). As in the proceedings before the reorganization court, Manufacturers and Kelley, Drye, in challenging the order under review, participated in a subordinate role on the appeal and on the certiorari proceedings; Covington & Burling took the lead as counsel to Penn Central. Manufacturers nevertheless did participate as it had to (and as it will continue to do if necessary) in its capacity as trustee under the remaining New York Central mortgages.

The upshot is that the New Haven interests still have not been paid by the Penn Central estate.[8]

II.

It was against this background that applications were filed on June 16, 1975 in the New Haven reorganization court by Manufacturers and several other bondholder representatives seeking compensation for services rendered and reimbursement of expenses, including attorneys' fees. The applications were filed pursuant to § 77(c)(12) of the Bankruptcy Act, 11 U.S.C. § 205(c)(12)(1970).[9] After a

---

8 The present balance due from the Penn Central is $121,959,605.02, according to the Statement of Assets, Liabilities and Capital Deficit as of September 30, 1976 submitted to the New Haven reorganization court on October 21, 1976 by counsel for the New Haven Trustee.

Professor Moore informed us at the time of oral argument that shortly prior thereto there had been submitted to the Penn Central reorganization court a consensual plan of reorganization for the Penn Central providing for payment to the New Haven interests of $174,000,000 or its equivalent.

9 Section 77(c)(12) of the Bankruptcy Act, 11 U.S.C. § 205(c)(12)(1970), in relevant part provides:

> "Within such maximum limits as are fixed by the Commission, the judge may make an allowance, to be paid out of the debtor's estate, for the actual and reasonable expenses (including reasonable attorney's fees) incurred in connection with the proceedings and plan by parties in interest and by reorganization managers and committees or other representatives of creditors and stockholders, and within such limits may make an allowance to be paid out of the debtor's estate for the actual and reasonable expenses incurred in connection with the proceedings and plan and reasonable compensation for services in connection therewith by trustees under indentures, depositaries and such assistants as the Commission with the approval of the judge may especially employ. Appeals from orders of the court fixing such allowances may be taken to the court of appeals independently of other appeals in the proceeding and shall be heard summarily. . . ."

Following the statutory procedure for § 77(c)(12) applications, the reorganization court originally referred the applications to the Interstate Commerce Commission so that the latter could set maximum levels of compensation. On February 5, 1976, however, Congress enacted the

hearing on May 18, 1976 the court filed its opinion, order, and judgment on June 30, 1976. To the extent here relevant,[10] the court allowed compensation to Manufacturers in amount of $103,018.34 as reimbursement for expenses and in amount of $304,416.67 as compensation for services. The court directed, however, that payment of the latter amount be contingent on the New Haven's recovery of the purchase price of its assets owed by the Penn Central. This was done by limiting Manufacturers' compensation for services to ¼ of 1% of the amount to be recovered by the New Haven from the Penn Central, such payment in no event to exceed $304,416.67. The contingent basis of the

---

Railroad Revitalization and Regulatory Reform Act (the 4R Act), Pub. L. No. 94-210, 90 Stat. 118. Section 618(b)(4) of the 4R Act in relevant part provides:

> "The powers and duties of the Commission under section 77 of the Bankruptcy Act (11 U.S.C. 205), with respect to a railroad in reorganization in the region which conveys all or substantially all of its designated rail properties to the Corporation or a subsidiary thereof, or to profitable railroads in the region, pursuant to the final system plan, and the requirement that plans of reorganization be filed with the Commission, shall cease upon the date of such conveyance. The powers and duties of the Commission under section 77 of the Bankruptcy Act shall also so terminate, as of the date of enactment of this paragraph, with respect to any railroad in reorganization under such section 77 but not subject to this Act which (1) does not operate any line or railroad, and (2) has transferred all or substantially all of its rail properties to a railroad in reorganization in the region which was subject to this Act prior to the date of enactment of this paragraph. Thereafter, such powers and duties of the Commission shall be vested in the district court of the United States which has jurisdiction of the estate of any such railroad in reorganization at the time of such conveyance. . . ."

Since the 4R Act terminated the Commission's jurisdiction over these applications and vested in the reorganization court the powers and duties of the Commission with respect to them, the applications were deemed refiled with the reorganization court.

10 In addition to the allowances granted to Manufacturers, the court granted allowances to various other participants in the reorganization, as set out in the schedule of payments at 421 F.Supp. at 272-73.

allowance to Manufacturers in this respect was grounded on the court's findings that Manufacturers had pursued interests adverse to the New Haven estate by representing the interests of the eighteen New York Central mortgages (which interests, except for the Gold Bond mortgage, it still is obliged to pursue); that such conduct constituted a breach of fiduciary duty under *Woods* v. *City National Bank & Trust Co.*, 312 U.S. 262 (1941); and that such breach "impeded, and therefore damaged, the New Haven reorganization trustee's collection of the sums owed the New Haven estate . . . and has frustrated the further development of a plan of reorganization for the New Haven . . . ." 421 F.Supp. at 266.

In addition to the allowance to Manufacturers itself referred to above, the court also allowed to Manufacturers the sum of $808,000.00 as compensation for its attorneys, Simpson Thacher & Bartlett, plus $15,234.81 as reimbursement for the latter's expenses.[11]

---

11 The court also allowed to Manufacturers a contingent fee on account of the legal services of Simpson Thacher. The contingent nature of this allowance has nothing to do with Manufacturer's breach of fiduciary duty. The award is a standard contingent fee. Simpson Thacher, along with two other law firms who had represented the first mortgage bondholders committee and the Chase Manhattan Bank (Migdal, Tenney, Glass & Pollak, and Dewey, Ballentine, Bushby, Palmer & Wood, respectively), participated in the New Haven reorganization proceedings on a contingent fee basis. Although the attorneys were successful in obtaining an increase in the purchase price for the New Haven assets as a result of the decision by the Supreme Court in the *New Haven Inclusion Cases, supra*, there was no cash payment. As Professor Moore stated at oral argument before us, "The price was excellent but the New Haven was paid in Confederate money." The New Haven reorganization court therefore ordered that "in the event that there is a future recovery by the reorganization trustee . . . of payments by the Penn Central . . ., on account of the purchase price fixed by the Supreme Court for the New Haven properties in the *New Haven Inclusion Cases*," each of the three law firms will receive a fraction of such payment or payments, 421 F.Supp. at 272. Simpson Thacher in that event would receive ¼ of 1% of the amount recovered.

The instant cross-appeals[12] were taken by Messrs. Iannotti and Zeldes, the respective successor indenture trustees under the New Haven's first and refunding mortgage and its general income mortgage, from that part of the court's judgment of June 30, 1976 referred to above. Appellees are Manufacturers and Richard Joyce Smith, the New Haven trustee. The latter has taken the position before us, as he did before the New Haven reorganization court, that, although Manufacturers was involved in a conflict of interest, it should not be denied compensation for services, expenses and attorneys fees. Appellants argue that Manufacturers should not recover *any* compensation for services, expenses, or attorneys' fees from the estate with which it had, and continues to have, a conflict of interest.

The questions thus presented are whether the New Haven reorganization court as a court of equity had the authority in the exercise of its discretion to allow compensation and expenses to Manufacturers and its counsel in view of Manufacturers' position of conflict; and, if so, whether the reorganization court exercised sound discretion in granting the allowances here involved.

III.

We turn to the first question presented: whether the reorganization court had the authority in the exercise of its discretion to grant any allowances at all to Manufacturers and its counsel.

---

12 Appellants' notices of appeal are denominated "cross-appeals" because they followed notices of appeal by Manufacturers and the Commission from the reorganization court's original order and judgment of June 30, 1976, as supplemented by its order of August 23, 1976. 421 F.Supp. at 273. The Commission's appeal was withdrawn and Manufacturers' appeal has not been pursued.

Appellants ask us to hold that Manufacturers cannot recover[13] any payments in the reorganization court—either "compensation for [its] services" or reimbursement of its "actual and reasonable expenses (including reasonable attorney's fees)". Appellants contend that, once a bankruptcy court finds a conflict of interest, it must close its eyes to the equities and disallow any and all payments. In short, appellants argue that the chancellor under such circumstances has open to him only one course: total disallowance of all payments; or, put another way, he has no discretion to act on the applications for allowances, even if his discretion is exercised on the basis of long familiarity with the reorganization, the undisputed value of the services of the fiduciary and its counsel, and the nature and cause of the conflict involved.

For the reasons below, we reject appellants' interpretation of the law. It would strip the reorganization court as a court of equity of its authority to exercise sound discretion. It would render equity inequitable.

As all counsel acknowledge, the late Judge Learned Hand was in the vanguard in articulating the equitable principles with which we are here concerned. A good starting point, it seems to us, is Judge Hand's reference to Aristotle's description of the role of "the equitable" in construing the law:

> "All law is universal but about some things it is not possible to make a universal statement which shall be correct. . . . Hence the equitable is just, and better

---

13 Appellants at the outset phrase the question presented as one of law: "[W]hether a former indenture trustee . . . *can recover* payments for compensation, expenses and attorneys' fees from the debtor's estate. . . ." (emphasis added). We note this not as a matter of semantics, but perhaps as an indication of the misapprehension of appellants' able counsel as to the role of a bankruptcy court as a court of equity, 11 U.S.C. §11 (1970), in dealing with the very unusual facts with which the reorganization court here was confronted.

than one kind of justice—not better than absolute justice but better than the error that arises from the absoluteness of the statement. And this is the nature of the equitable, a correction of law where it is defective owing to its universality. . . ." Ethics, Book V, Chapter 10 fol. 1137, lines 12-28, in IX *The Works of Aristotle* (W.D. Ross trans. 1925), *quoted in* L. Hand, The Bill of Rights 21-22 (1958).

Having in mind that flexibility is one of the essential characteristics of equity and that conceptions of equity necessarily will vary from chancellor to chancellor, the thread that runs consistently through the cases is that the remedy granted or penalty imposed by equity must be tailored to fit the particular case at hand.

This brings us to the applicable case law. We are not aware of any case in which a railroad reorganization court has construed the effect of a conflict of interest on an application for compensation under §77(c)(12)—the provision pursuant to which the instant application was filed. The courts, however, have considered the issue under Chapter X and its predecessor, §77B.

The leading cases which we believe at least point to the correct decision here are two Supreme Court opinions, *Woods* v. *City National Bank & Trust Co.*, 312 U.S. 262 (1941); *Wolf* v. *Weinstein*, 372 U.S. 633 (1963), and two opinions written by Judge Learned Hand for our Court, *Berner* v. *Equitable Office Building Corp.*, 175 F.2d 218 (2 Cir. 1949); *Silbiger* v. *Prudence Bonds Corp.*, 180 F.2d 917 (2 Cir.), *cert. denied*, 340 U.S. 813 (1950). We shall discuss each briefly to the extent here applicable.

Woods v. *City National Bank & Trust Co., supra*, is the leading Chapter X case in point. It recognizes the inherent discretionary *power* of a reorganization court to disallow compensation for services and expenses on the ground of

conflict of interest; but it does not *require* that a reorganization court do so. The Court in *Woods* did not reject a district court's allowance of compensation; rather, it reversed the court of appeals' reversal of the district court, noting that the district court's findings of a conflict that warranted complete disallowance were "amply supported by the evidence." 312 U.S. at 269.[14]

It is clear from the opinion in *Woods* that the Court was considering the power of a reorganization court to deny compensation, not its obligation to do so. "The basic question involved in this case concerns the power of the District Court in proceedings under Ch. X of the Chandler Act (52 Stat. 840) to disallow claims for compensation and reimbursement on the grounds that the claimants were serving dual or conflicting interests." *Id.* at 262 (footnote omitted). The Court went on to explain that this power derives from the "bankruptcy court['s] . . . plenary power to review all fees and expenses in connection with the reorganization . . . ." *Id.* at 267. See also *American United Mutual Life Ins. Co.* v. *City of Avon Park*, 311 U.S. 138, 146 (1940) (involving a plan for the composition of the

---

14 The nature of the conflict of interest in *Woods* was in sharp contrast to that in the instant case. There, claims for compensation were filed by an indenture trustee, the members of a bondholders' committee, and the committee's counsel. The bondholders' committee, originally organized by the indenture trustee, included employees of the indenture trustee's corporate reorganization department as well as employees of an underwriter heavily interested in the debtor's stock and under threat of suit for defrauding the bondholders. The same firm of attorneys which had been retained by the indenture trustee was employed by the committee. Thus the interlocking personnel of the committee and the indenture trustee represented the depositing bondholders who were interested in having a low upset price fixed for the debtor's property, the non-depositing bondholders who were interested in a high upset price, and a large stockholder who sought a favorable position in the reorganization at the expense of both. The essential ground upon which the reorganization court disallowed the claims for compensation was that the claimants were pursuing interests of their own that were either of no benefit to the estate or were adverse to it.

debts of a municipality under Chapter IX of the Bankruptcy Act).[15]

We do not overlook other language in *Woods* that can be read more broadly. For example, "[w]here a claimant, who represented members of the investing public, was serving more than one master or was subject to conflicting interests, he should be denied compensation." 312 U.S. at 268. This statement of the general rule of course is understandable in view of the particular facts and actual holding of the case. See note 14 *supra*. Application of the general rule in *Woods* led to and buttressed the district court's denial of compensation and pointed up the error of the court of appeals in reversing the district court. *Woods'* recognition of the general rule, however, does not strike us as a mandatory requirement that reorganization courts woodenly must deny compensation in every case of conflict of interest, regardless of the facts.[16]

---

15 The Court in *American United*, 311 U.S. at 145, in reaffirming the essential character of a bankruptcy court as a court of equity, quoted from the seminal opinion in *SEC* v. *United States Realty & Improvement Co.*, 310 U.S. 434, 455 (1940):

> "A court of equity may in its discretion in the exercise of the jurisdiction committed to it *grant or deny relief upon performance of a condition which will safeguard the public interest.*" (emphasis added).

16 We view likewise the statement of the Court in *Woods* that "[w]here an actual conflict of interest exists, no more need be shown in this type of case to *support* a denial of compensation." 312 U.S. at 268 (emphasis added). That is precisely what the Court held in *Woods*, namely, that the findings of the district court were sufficiently supported by the evidence to warrant denial of compensation. The Court did not hold that denial of compensation would be required regardless of the district court's findings.

Moreover, the voluntarily assumed conflict-laden situation in *Woods*, see note 14 *supra*, is a far cry from the unusual circumstances of the instant case. We need not decide here whether the Court's approval of the denial of compensation in *Woods* requires that compensation always be denied in factually similar situations. See *In re Ritz Carlton Restaurant & Hotel Co.*, 60 F.Supp. 861, 865-66 (D.N.J. 1945). *Woods* certainly provides guidance to the reorganization courts on the issue. See generally *In re American Acoustics*, 97 F.Supp. 586, 589 (D.N.J. 1951). By the same token, however, *Woods* does not relieve a reorganization court of its duty, once it has found a conflict, to weigh the facts of a particular case for and against allowing compensation.

This need for flexibility to be exercised by a reorganization court in dealing with a conflict of interest has been recognized by our Court in the two corporate reorganization cases referred to above which were decided after *Woods*.

In *Berner* v. *Equitable Office Building Corp.*, *supra*, a Chapter X case, the district court had completely disallowed compensation to Berner, an attorney, apparently on the basis of §249 of the Bankruptcy Act, 11 U.S.C. §649 (1970), which denies all compensation to a fiduciary who has traded in the debtor's stock.[17] Our Court, in an opinion by Judge Learned Hand, reversed the district court on the ground that there had not been adequate proof that Berner had acquired an interest in the debtor's stock. In the course of the opinion which reviewed the applicable authorities, including *Woods*, 175 F.2d at 220 & n. 3, Judge Hand stated that "there was no proof of conduct which necessarily forfeited his rights either under §249, or upon general equitable principles; *but that there was proof of conduct which required his allowance to be reduced in an amount which the district court should fix in its discretion. . . .*" *Id.* at 219 (emphasis added). Thus, after concluding that Berner's conduct in divulging inside informa-

---

17 Section 249 of the Bankruptcy Act, 11 U.S.C. §649 (1970), in relevant part provides:

> "No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity who at any time after assuming to act in such capacity has purchased or sold such claims or stock or by whom or for whose account such claims or stock have, without the prior consent of the judge, been otherwise acquired or transferred."

tion to one Bell, who did purchase shares, amounted to a breach of trust to the shareholders from whom Bell had bought, Judge Hand remanded the case to the district court with these instructions:

> "[W]e think that the consequences should be only those which attend any breach of trust in equity: i.e., that in determining what the trustee's compensation shall be, the court will, as a matter of discretion diminish the allowance which it would otherwise make, in proportion to the gravity of the breach." *Id.* at 222 (footnote omitted).

In *Silbiger* v. *Prudence Bonds Corp., supra,* a §77B case, where an attorney represented members of two classes of bondholders whose interests conflicted, the district court had allowed compensation to the attorney, to be paid from funds distributed to the holders of the series of bonds which were fully compensated in the reorganization. Judge Learned Hand, who again wrote the opinion for our Court, expressly followed the course taken in *Berner* of leaving to the discretion of the district court "[h]ow far the penalty [because of the conflict of interest] should be mitigated," 180 F.2d at 921, and remanded the case to the district court for that purpose.

We recognize, as Judge Hand noted in *Silbiger,* that "the usual consequence has been that [an attorney who represents opposed interests] is debarred from receiving any fee from either, no matter how successful his labors", *id.* at 920, and that usually "the prohibition is absolute and the consequence is a forfeiture of all pay." *Id.* at 921. We further recognize that the salient distinguishing factor relied upon in *Silbiger* was the fact that the "attorney [was] not paid in any part by the side he [had] opposed", or, expressed differently, that "the allowance . . . [came]

in no part out of any group that [could] have been prejudiced by the attorney's divided allegiance." *Id.* at 921.

By contrast, any allowance to Manufacturers in the instant case necessarily will diminish the funds available to meet the obligations of the New Haven estate to the holders of its general income bonds and may diminish the payment to its first mortgage bondholders. Yet the presence of the particular circumstance which justified our departure from the general rule in *Silbiger* should not be treated as a necessary condition for departing from the general rule in all caess. The critical point is that because of the particular exceptional circumstance in *Silbiger* we concluded that to deny the attorney compensation would be inequitable, contrary to the rationale for denying compensation in the first place. We did not rule out the possibility that there might be other, equally compelling, exceptional circumstances. In short, we decline appellants' invitation to us to construe *Silbiger* in a way that would render equity inequitable in the instant case.[18]

This brings us to *Wolf* v. *Weinstein, supra,* another Chapter X case, which appellants say worked a radical change in the law. They argue that after *Wolf* the flexibility that traditionally inhered in a court of equity's treatment of applications for compensation no longer is permissible. We disagree. We believe that *Wolf* bears only

---

18 Our holdings in *Berner* and *Silbiger* have been followed by the Seventh Circuit in *Chicago & West Towns Rys.* v. *Friedman,* 230 F.2d 364 (7 Cir.), *cert. denied,* 351 U.S. 943 (1956). There a law firm represented both a committee of the debtor's bondholders and a potential buyer of the debtor. The Court of Appeals, in reducing the district court's award from $12,000 to $7,000 because of the firm's involvement in a clear conflict of interest between buyer and seller, recognized that the district court could have disallowed the fee completely on the authority of *Woods.* The Court of Appeals chose instead to follow the "less harsh rule" of *Silbiger* and *Berner,* which would impose a "penalty of less than full forfeiture". 230 F.2d at 369.

marginally, if at all, on the question presented by the instant appeal.

The issue in *Wolf* was whether certain persons who had traded in the debtor's stock during the reorganization proceedings were fiduciaries so as to trigger the prohibition against compensation provided in §249 of the Bankruptcy Act.[19] The district court held they were. We held they were not. The Supreme Court agreed with the district court. It was undisputed that §249 would operate automatically to deny all compensation to the President and General Manager of the debtor *if* they were considered "other person[s] acting in the proceedings in a . . . fiduciary capacity" within the meaning of the statute. *Wolf* involved *who* comes under the statute, not whether the statute's prohibition against compensation is absolute, automatic, and admitting of no exceptions. The only question before the Court was whether "§249 was meant to broaden the classes of fiduciaries to be subjected to [the] traditional sanction" of denying compensation. 372 U.S. at 645. The Court held that it was.

In reaching its decision, the Court discussed the legislative history and purpose of §249. It treated the problem essentially as one involving "the evil of insider trading by fiduciaries during corporate reorganization." Note, 37 Temp. L.Q. 342 (1964). This is quite apparent from its discussion of §249, together with §16(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78p(b) (1970), as a dual attack by Congress on a single problem, 372 U.S. at 643, and its recognition of the "common origins and parallel purposes of §249 and §16(b)". *Id.* at 643 n. 11. The Court noted with approval the suggestion of several courts "that a paramount objective of §249 was to check the misuse for private gain of inside information or control, to which the

19 See note 17, *supra*.

position of a representative or fiduciary gives him access." *Id.* at 642 n. 10. As in §16(b) cases, the Court had little trouble in applying §249 without exception "[i]n the light of its clearly revealed objectives." *Id.* at 643.

The Court made it clear that §249 is based on traditional equitable principles. Even before 1938, when Congress enacted §249 as part of the Chandler Act,

> "§77B's broad mandate that fees and allowances must be 'reasonable' to merit judicial approval had been held sufficient authority by two federal courts to sanction denial of compensation to persons holding fiduciary positions in reorganization proceedings who had traded in the Debtor's stock. *In re Paramount-Publix Corp.*, 12 F.Supp. 823, 828, rev'd in part, 83 F.2d 406; *In re Republic Gas Corp.*, 35 F.Supp. 300. These decisions found even in the general terms of the statute the embodiment of 'ancient equity rules governing the conduct of trustees, including deprivation of compensation where there is a departure from those rules.' . . . ." 372 U.S. at 641.

Appellants argue, on the basis of the Court's recognition in *Wolf* of the roots of § 249 in equity, that that statute's absolute prohibition against compensation should apply by analogy to *all* cases involving fiduciaries' applications for compensation. They seek to transform the narrow holding of *Wolf* and its discussion about the antecedents of § 249 into a binding interpretation of the rule of equity applicable to all applications for compensation by fiduciaries. In this manner appellants attempt to avoid the critical fact that *Wolf* dealt with a specific statutory rule.

To recognize, however, that § 249 is based on equitable principles, or even that it codifies the rule of certain equi-

table decisions, does not reduce the broad realm of equity to the requirements of § 249. The lesser does not include the greater. Congress may have made the general rule the only rule, without room for exception, for the purpose of dealing with a particular form of breach by fiduciaries, but it most assuredly did not purport to reach all kinds of conflicts of interest. Granted that trading in the debtor's stock is a form of conflict of interest in which the fiduciary is torn between his duty to the debtor and his own self-interest. In a particular case the harm may vary in degree and it may be more or less deserving of sanction than other forms of breach of a fiduciary. Congress chose, however, to single out insider trading as a form of disloyalty particularly to be discouraged, even in cases of little or no actual harm. Surely equity may deny all compensation in other cases of disloyalty; but just as surely, equity is not required to do so. The Supreme Court recognized this in *Wolf* when it stated that "there are various forms of disloyalty or conflict of interest which would disentitle an officer to compensation under general principles of equity and quite without regard to any statutory provision." 372 U.S. at 647-48 (footnote omitted). In those cases, however, traditional notions of equity govern; § 249 and *Wolf* are inapplicable.[20]

---

20 We are not persuaded by appellants' argument that, because §249 gives effect to traditional equitable principles, the Supreme Court in *Wolf* considered the admittedly harsh impact of §249 to be representative of those principles, as embodied for example in *Woods*. By giving effect to a specific statutory provision and noting that such effect was not inconsistent with what had been done before, we do not believe that the Court meant to equate §249 with the "traditional sanction". Although appellants are correct that the holding in *Wolf* is not that §249 imposes a harsher penalty on certain fiduciaries than would general equitable principles, they fail to recognize that §249 requires imposition of the penalty regardless of the equities. Section 249 may not increase the harshness of the sanction in a particular case, but it increases the frequency of the sanction and unshrinkingly compels its imposition in every case in which it applies. Therein lies its harshness.

Despite the vigor with which appellants urge their *"Woods/Wolf* synthesis", we think it is clear that *Wolf* deals only with §249 and was not intended to imply a radical change in one of equity's essential characteristics. As one commentator has stated the distinction between the rigid statutory bar of §249 and the more flexible equitable principles:

> "The problem of *Wolf* v. *Weinstein* is a close and a difficult one. It is not the question whether insider trading shall go unregulated and uncontrolled. It is the problem whether it should be governed by §249, with its rigid penalty and its automatic impact or whether it should be dealt with by the more flexible doctrines of equity. The statutory remedy is more sure and direct in its impact; the equitable one presents greater difficulties of proof, need not be as severe, and can be tailored in its sanction to meet particular situations."

Kaplan, *Wolf* v. *Weinstein: Another Chapter on Insider Trading*, 1963 S. Ct. Rev. 273, 290.

Absent a statutory directive at least as clear as the Court thought § 249 to be, we see no warrant for requiring a court of equity to close its eyes to the harshness of a result "in proportion to the gravity of the breach." *Berner, supra*, 175 F.2d at 222. A majority of the Court in *Wolf* was not troubled by the harshness of the result,[21] in part because the result was

> "wholly consistent with the uniform application of [§ 249] by the lower courts. As the Court of Appeals for the Second Circuit [had] recognized in an earlier case, '[t]his result may well work harshly in individual cases . . . . But in § 249 . . . Congress clearly intended drastic results and thought them necessary to eliminate the serious abuses of insider information which had long been existent in equity reorganizations.'"

---

21 But see Mr. Justice Harlan's dissent:

> "On that score I fully agree with Judge Friendly that at 'the very least, courts are justified in demanding a clear indication of Congressional purpose before inflicting' such a 'Draconian penalty' (296 F.2d at 683) as the Court's decision now imposes on petitioners. . . ." 372 U.S. at 657.

372 U.S. at 654 (quoting *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea*, 266 F.2d 862, 868 (2 Cir. 1959).[22]

The Court could hardly have made it more plain in *Wolf* that universal harshness, absent a statutory directive, was far from its intended result:

> "In light of the seriousness of the abuses which the statute was designed to prevent, it has been thought that to allow a[n] . . . exception or dispensation would frustrate the manifest intent of Congress to impose an effective prophylactic rule. That the rule occasionally bars compensation to those whose conduct might not have been considered inequitable or disloyal in the absence of such a statute is no reason to suspend or make selective the operation of the statute's sanctions." 372 U.S. at 655-56 (footnote omitted).

We hold that the New Haven reorganization court here, absent any statutory directive such as § 249, correctly concluded that it had discretion as a court of equity to act on the instant applications without being bound by an absolute rule prohibiting compensation in a case of conflict of interest regardless of the facts. We decline to alter the essential nature of the equitable rule or to prohibit a correction of law where it would be defective owing to its universality.

---

22 Appellants argue that in *Surface Transit* we indicated that the discretionary approach of *Berner, supra*, might no longer be the law of this Circuit. We find it neither necessary nor appropriate for us to rule on the effect of *Surface Transit* as a §249 case on *Berner*, for *Surface Transit* certainly does not undermine Judge Hand's view of equity's discretion in the context of a case such as the instant one where that statutory provision is not even arguably relevant.

IV.

We turn next to the second question presented: whether the reorganization court exercised sound discretion in allowing the compensation and expenses in question. We hold that it did.

Judge Anderson had presided over the New Haven reorganization continuously since its inception in 1961. He was fully aware of all the vicissitudes of the extraordinarily difficult and complex proceedings. He knew the attorneys and parties involved. He was uniquely well qualified to assess their respective contributions. He was personally cognizant of all of the circumstances attending Manufacturers' conflict of interest, and was in the best position to evaluate its bearing on the reorganization. He, more than anyone else, knew the value of the assistance of imaginative and cooperative creditor representatives in helping with whatever steps were necessary to keep the trains running. Under such circumstances, appellants have a heavy burden of demonstrating that this experienced judge, in dealing with the delicate situation presented by Manufacturers' application for compensation and expenses, failed to act conscientiously and fairly—in short, that he abused his discretion.

Although the reorganization court found a conflict of interest on the part of Manufacturers, it made very clear that Manufacturers was not at fault:

> "The Manufacturers Hanover Trust Company, *through no action of its own, found itself in a position between conflicting interests*, as to each of which it was in a position of indenture trustee. It could not help one without hurting the other." 421 F.Supp. at 266 (emphasis added).

The italicized words emphasize the court's critical finding of fact with respect to the salient characteristic of this conflict of interest: it was completely involuntary.

A basic tenet of trust law is that "[o]rdinarily a trustee does not commit a breach of trust if he does not intentionally or negligently do what he ought not to do or fail to do what he ought to do." Restatement (Second) of Trusts §201 (1959), comment a. The element of voluntariness is critical.[23] Manufacturers did not commit a breach of trust simply by finding itself between conflicting interests when the Penn Central filed for reorganization. If there was a breach at all, it would have occurred when Manufacturers failed to extricate itself from the conflict.

The court, however, found that Manufacturers made every possible effort to extricate itself. It was not until the court decided to replace the bank with an individual that a successor trustee could be found. It is true that all concerned agreed that Manufacturers should have resigned immediately from its trusteeships on one side or the other, or both. The Chairman of the Board of Manufacturers believed that that was the right thing to do. But that does not support appellants' assertion that the court would have ordered Manufacturers to resign if it had petitioned the court for instructions. To resign at the very moment the bondholders needed representation at the hearings on whether an equitable lien should be declared in New

---

23 Compare the undiscriminating effect of §249:

"It is not only voluntary purchases or sales of a debtor's securities to which Section 249 applies. It denies compensation as well to any person acting in a reorganization proceeding in a representative or fiduciary capacity *for whose account* claims against or securities of the debtor have been purchased or sold without the prior consent or subsequent approval of the judge in the reorganization proceeding. The bona fides of such purchases or sales is not material under Section 249." *In re Cosgrove-Meehan Coal Corp.*, 136 F.2d 3, 5-6 (3 Cir. 1943) (emphasis in original).

Haven's favor would not have fulfilled Manufacturers' fiduciary duties. Whatever Manufacturers did—resign and leave the bondholders helpless or stay on in the middle of a conflict—would not have comported with the duty it owed to the bondholders on each side. In view of the irrebuttable fact that Manufacturers was in a complete bind, the question is whether there was *anything* Manufacturers could have done that would save Manufacturers' right to compensation in the opinion of the successor trustees. Beyond asserting that Manufacturers should have taken immediate steps "to withdraw from one side or the other or both", appellants reply that Manufacturers should have petitioned the court for instructions, see *Mosser* v. *Darrow*, 341 U.S. 267, 274 (1951); *Silbiger* v. *Prudence Bonds Corp.*, *supra*, 180 F.2d at 921; Restatement (Second) of Trusts §259 (1959), or should have taken the firm stand that it would resign unless directed by the court to stay on. Although such action on Manufacturers' part would have served immeasurably to clarify matters, we do not view Manufacturers' failure to do so as dispositive under the circumstances of this case.

It is easy to look back years later and rethink Manufacturers' alternatives. But viewing the situation realistically, it is clear that the court was aware of the conflict; that Manufacturers was not trying to conceal anything; and that the court's order that briefs be filed and a hearing held on the equitable lien issue required immediate action by all parties. Someone had to represent the bondholders at the August 1970 hearing, which took place while the search for a successor trustee was under way. Manufacturers had no sooner conceived the idea to resign than its attorneys, on both sides, advised that it could not resign without leaving the bondholders stranded. Thus, on the advice of both of its firms of attorneys, Manufacturers

chose the best *possible* alternative, by having each firm represent separately the respective interests.[24]

Under such circumstances, a petition for instructions or a gesture of resignation would have been futile. The law does not require that one act in vain. Although a petition for instructions might have been fruitful in assuring that no question could be raised later about Manufacturers' right to compensation, see *Mosser* v. *Darrow, supra,* 341 U.S. at 274, that is irrelevant to the question whether such action would have better protected those to whom Manufacturers owed a fiduciary duty. It is unlikely that a petition for instructions would have resulted in any material change in Manufacturers' course of action. The likely futility of petitioning for instructions distinguishes this case from others in which the failure to seek instructions was deemed significant. Yet even in *Silbiger, supra,* where the court might well have instructed the attorney to cease his representation of opposing interests and where nothing justified the attorney's failure to seek instructions from the court, we held that the penalty of full forfeiture should be ameliorated in the discretion of the district court.[25]

---

24 Appellants and the reorganization court discuss this so-called "insulation theory" as if it were an affirmative notion on the part of Manufacturers. The opinion below states that Manufacturers' "first solution was to assign one of its lawyers to one side and another of its lawyers to the other." 421 F.Supp. at 265. This is perhaps an oversimplification in view of the facts related above about the history of the merger of the respective trustees under the different indentures and Manufacturers' continuous use of separate counsel for what became the two sides of this conflict. See *ante* at pp. 2443-2444. Indeed, the availability of separate counsel already representing each side was the single positive fortuity in this very difficult situation.

25 We wish to emphasize that our holding in the instant case is not to be construed as sanctioning dilution of the rule that a fiduciary in doubt should petition the court for instructions. We merely hold that Manufacturers' failure to do so under the unique circumstances of this case does not operate as an automatic bar to Manufacturers' compensation.

Of crucial significance here is the undisputed fact that the indenture trustee's services and those of its counsel were of tremendous value to the estate from 1961 until the conflict arose in June 1970.[26] No one has challenged the value of those services.[27] At oral argument appellants corroborated appellees' representation that the "vast majority of the claim" related to services rendered before the conflict arose. Appellants stated that "the bulk of the hours logged by Manufacturers and its lawyers without question occurred prior to the conflict . . . ." This factor properly was taken into account by the reorganization court. The absolute principle that "an applicant [under §249] who has engaged in forbidden transactions near the end of the proceeding is to be denied compensation for all

---

26 The Restatement (Second) of Trusts §243 (1959), comment c, sets out the following as guidelines for the exercises of a court's discretion in deciding whether a trustee who has committed a breach of trust should receive full compensation or whether his compensation should be reduced or denied:

> "(1) whether the trustee acted in good faith or not; (2) whether the breach of trust was intentional or negligent or without fault; (3) whether the breach of trust related to the management of the whole trust or related only to a part of the trust property; (4) whether or not the breach of trust occasioned any loss and whether if there has been a loss it has been made good by the trustee; (5) *whether the trustee's services were of value to the trust.*" (emphasis added).

In this case, Manufacturers beyond doubt acted in good faith and was not at fault for the breach of trust. Although the breach concededly affected the whole trust property and occasioned a loss, the court took that into account in making Manufacturers' compensation contingent on New Haven's recoupment of the loss.

27 The court's opinion states that, had it not been for the existence of the conflict of interest, the reorganization court "would, on careful review, ordinarily [have found] that there was sufficient *unchallenged* and competent evidence to qualify [Manufacturers' services] as legitimate charges. . . ." 421 F.Supp. at 263 (emphasis added). Appellants did not challenge the value of the services before us. For this reason, we find it neither necessary nor appropriate for us to review the reorganization court's exercise of discretion in passing on the applications for compensation except to the extent relevant to the conflict of interest.

services he has rendered to the Debtor, however valuable those services may have been," *Wolf* v. *Weinstein, supra,* 372 U.S. at 654, is no more applicable to this case than is §249 itself.[28] To permit the New Haven estate to retain the benefit of those services without paying for them would amount to a windfall for the New Haven.

We hold that the court, having found a breach of fiduciary duty, properly tailored the remedy to the nature of the breach it found.

V.

Finally, we address ourselves, as the reorganization court did, 421 F.Supp. at 267-69, to the different footings upon which rest (1) the allowance to Manufacturers for its own compensation and expenses, and (2) the allowance to Manufacturers for compensation and expenses of its attorneys. Whatever may be said arguendo with respect to the merit of the objections to the former, we hold that there is no merit whatever to the objections to the latter.

Under §77(c)(12) Manufacturers as the indenture trusteee filed an application covering both claims referred to above. The court granted the allowance for attorneys' fees to the indenture trustee for and on account of its attorneys, as an expense of the trustee, rather than as direct compensation to the attorneys as claimants. In this respect §77(c)(12) differs from §242 of the Bankruptcy Act, 11 U.S.C. §642 (1970), under which attorneys for specified claimants may apply for compensation on their own behalf.[29] Appellants argue, based on this statu-

28 That the quoted sentence from *Wolf* refers specifically to §249 is apparent from the Court's citation of *In re Cosgrove-Meehan Coal Corp.*, 136 F.2d 3 (3 Cir. 1943), which also dealt with §249.

29 Before passage of the Chandler Act in 1938, the predecessor of §77(c)(12), then codified as 11 U.S.C. §205(c)(8), provided that the court could,

> "within such maximum limits as are fixed by the commission . . . allow a reasonable compensation for the services rendered and reimbursement for the actual and necessary expenses incurred in connection with the proceeding and plan by officers, parties in interest, reorganization managers, and committees or other representatives of creditors or stockholders, and the attorneys or agents of any of the foregoing. . . ."

This language resembles that of 11 U.S.C. §642. The present §77(c)(12) was proposed as an amendment during the debates on the Chandler Act. Originally the proposed amendment did not provide for compensation to any participants in a reorganization; it provided only for reimbursement of actual and reasonable expenses. See 79 Cong. Rec. 13304 (1935). Representative Sumners offered an amendment to proposed §77(c)(12) which became the present section. *Id.* at 13307. In committee the matter of compensating attorneys had been "one of the highly controversial issues". "A large percentage of the committee felt that each class should pay their own attorney fees." The committee rejected this view, however, because it was thought that the difficulties of railroad reorganization were too great to run the risk of creating a disincentive to effective legal representation. "[T]he committee was afraid to take the responsibility to eliminate these fees." *Id.* (remarks of Rep. Sumners). In the debates on the Senate bill, the House amendment was explained further:

> "The present provisions of section 77 allow both expenses and fees to be paid to the designated interested parties out of the debtor's estate. . . . The House Judiciary Committee . . . eliminated fees entirely, allowing only expenses. On further investigation it found that this was too rigorous. The effect of the amendment is to allow expenses to all the interested parties and fees only to trustees under indentures, depositaries, and such assistants as are especially employed by the Commission with the approval of the Judge." *Id.* at 13765 (remarks of Sen. Wheeler).

Thus compensation may be awarded only to a limited class of applicants, but compensation to attorneys may be allowed as a form of expense.

tory pattern, that attorneys' fees cannot be paid from the estate when the claimant's right to compensation is in doubt or is denied because of a conflict of interest. On the facts of this case we disagree. We hold that, even if Manufacturers were barred from receiving compensation for its own services, the reorganization court would not have abused its discretion in allowing attorneys' fees to Manufacturers on behalf of Simpson Thacher.

We recognize, as appellants point out, that the discussion of expenses in *Woods* is not really applicable here. In

Woods the Supreme Court distinguished reimbursement of expenses from compensation for services, explaining:

> "The rule disallowing compensation because of conflicting interests may be equally effective to bar recovery of the expenditures made by a claimant subject to conflicting interests. Plainly expenditures are not 'proper' within the meaning of [§ 242 of] the [Bankruptcy] Act where the claimant cannot show *that they were made in furtherance of a project exclusively devoted to the interests of those whom the claimant purported to represent.* On the other hand, those expenditures normally should be allowed *which have clearly benefited the estate.* . . . Thus where taxes have been paid, needful repairs or additions to the property have been made, or the like, *equity does not permit the estate to retain those benefits without paying for them.* Such classification of expenses, at times difficult, rests in the sound discretion of the bankruptcy court." 312 U.S. at 269-70 (emphasis added).

The Court did not have expenses such as attorneys' fees in mind since attorneys could apply directly to the court for compensation. But the reasons for the difference between §§ 242 and 77(c)(12), see note 29 *supra*, are unrelated to the issue before us. Section 77(c)(12) therefore should not be interpreted to impose a special burden on a claimant in obtaining reimbursement of expenses which would be allowed to the attorneys themselves if they could make their own claim, as under § 242, and which qualify as reimbursable expenses under the criteria articulated in *Woods*.

Applying the *Woods* criteria, we believe there can be no doubt that the attorneys' fees here in question were reasonable expenses "which have clearly benefited the estate." Besides its participation in myriad facets of the New Haven reorganization from its inception on July 7, 1961 until August 30, 1971, Simpson Thacher's services during the *New Haven Inclusion Cases* litigation contributed substantially to the Supreme Court's setting a purchase price for the New Haven's assets about $50 million higher than the price agreed to by the New Haven trustees, or an increase of about 40%. That the purchase price remains unpaid is in no way attributable to Simpson Thacher.[30] Although the expenses mentioned in *Woods* (taxes, repairs, additions, "or the like") are more routine than attorneys' fees, and their propriety more easily discernible, their benefit to the estate is not necessarily greater than attorneys' services. Evaluation of the benefit of the attorneys' services here is not a problem because of the quantifiable value of the *New Haven Inclusion Cases* judgment and Judge Anderson's complete familiarity with the entire course of this reorganization. Unlike repairs, payment of taxes, and the like, which usually do no more than preserve the status quo, Simpson Thacher's services contributed very substantially to an increase in the value of the estate's assets. It truly would be inequitable to "permit the estate to retain those benefits without paying for them." 312 U.S. at 270.

---

30 Appellants contend that Simpson Thacher itself contributed to the conflict of interest by advising Manufacturers not to resign and to have the two sides of the conflict represented by separate counsel (the so-called "insulation theory"). We do not accept the inference that this legal advice was anything more than an informed choice of the lesser of two evils. We therefore decline to amplify its significance. Simpson Thacher had no dealings with or obligations to the Penn Central interests. It therefore was not tainted itself by the conflict at all. Whatever advice it gave Manufacturers was given solely in the best interests of the New Haven interests.

Appellants contend that it is Manufacturers' responsibility to pay the attorneys' fees. We fail to see how the fact of its conflict of interest makes Manufacturers, which derived no benefit of its own from the legal representation, responsible for paying Simpson Thacher, notwithstanding Manufacturers' assertion that it probably would feel morally, but not legally, obligated to pay the firm if the estate did not.

Surely the law firm's work for the indenture trustee was "a project exclusively devoted to the interests of those whom the claimant purported to represent." This factor makes appellants' reliance on *Mosser* v. *Darrow*, 341 U.S. 267 (1951); *In re American Acoustics, Inc.*, 97 F.Supp. 586 (D.N.J. 1951); and *In re Ritz Carlton Restaurant & Hotel Co.*, 60 F.Supp. 861 (D.N.J. 1945), misplaced.

In *Mosser* a reorganization trustee who himself did not trade in securities of the debtor's subsidiaries was surcharged for profits made by his two key employees on the ground that he expressly permitted them to engage in such trading. Without such permission the employees would not have remained. We are mindful of the Court's observation in *Mosser* that the strict prohibitions on "profiting out of [a] position of trust", 341 U.S. at 273, "would serve little purpose if the trustee were free to authorize others to do what he is forbidden." *Id.* at 271. That observation is not relevant to the relationship between Manufacturers and Simpson Thacher. Manufacturers did not authorize Simpson Thacher to pursue the conflicting interests that Manufacturers were forbidden to pursue. Manufacturers authorized Simpson Thacher to provide the New Haven interests the "loyal and disinterested service", *Woods, supra*, 312 U.S. at 268, which it knew to be a fiduciary's obligation but which it realized it had become unable to render. We believe that the facts of *Mosser* are completely unlike those of the instant case. The Court in

Mosser took note of the employees' pursuit of self-interest which was encouraged by the trustee. It was in that context of a "willful and deliberate setting up of an interest in employees adverse to that of the trust" that the Court concluded, "We think that which the trustee had no right to do he had no right to authorize, and that the transactions were as forbidden for benefit of others as they would have been on behalf of the trustee himself." 341 U.S. at 272.

The attorneys who were denied compensation in *American Acoustics* and *Ritz Carlton* had represented conflicting interests themselves. The attorney in *American Acoustics* had no relationship to the trustee. He represented the debtor, its creditors, and the mortgagee in possession, all of whose interests were adverse. In *Ritz Carlton* the court denied compensation to a trustee's attorney when the trustee himself was denied compensation because he had served adverse interests. It is clear from the facts of *Ritz Carlton*, although the point is not made explicitly by the court, that in representing the trustee who had served adverse interests, the attorney also had represented the adverse interests. In such a situation it is understandable that the trustee and his attorney should be treated alike. That, however, is not the situation in the instant case. Here the trustee and the attorneys self-consciously made sure that whatever taint infected the trustee would not infect the attorneys, so that the bondholders on either side would be protected. We believe that the instant case is distinguishable from *American Acoustics* and *Ritz Carlton*.

We hold under this section of our opinion that the reorganization court acted well within permissible bounds of discretion in granting to Manufacturers an allowance for compensation and expenses of its attorneys, whether or not Manufacturers should have been compensated for

its own services. Under the circumstances we do not believe that the provision of § 77(c)(12), by which the indenture trustee claims compensation for its attorneys as an expense, should alter what otherwise would be Simpson Thacher's clear right to compensation.

Affirmed.

Relevant Portions of Opinion of the United States District Court for the District of Connecticut

—249—

UNITED STATES DISTRICT COURT

D. CONNECTICUT

No. 30226

In the Matter of the NEW YORK, NEW HAVEN & HARTFORD RAILROAD COMPANY,

Debtor.

June 30, 1976.

Opinion Supplemented and Clarified,
Aug. 23, 1976.

In proceedings for the reorganization of a railroad, applications were filed for compensation and for reimbursement of expenses incurred on behalf of the bankrupt estate. The District Court, Robert P. Anderson, Circuit Judge, sitting by designation, held that the evidence established that the applicants were entitled to, inter alia, expenses, fees for services rendered as indenture trustees, and counsel fees, in varying amounts.

Applications granted in part and denied in part.

• • • • •

—262—

3. *MANUFACTURERS HANOVER TRUST COMPANY,* as Indenture Trustee for the Debtor's First and Refunding Mortgage.

With regard to the expenses incurred by the indenture trustee, none of the items has been contested. It is noted

—263—

that, as set out in the affidavit of Mr. Kaestnor, a Senior Vice President of the petitioner, the item of $91,398.26, an advance to Simpson, Thacher & Bartlett, has been properly deleted because it is reimbursable. The court finds the account of the sums expended is correct and that they were reasonable and necessary. They are, therefore, approved and allowed under § 77(c)(12), and ordered to be paid as hereinafter set forth by the reorganization trustee to the petitioner in the amount of $103,018.34.

As far as services of the Manufacturers Hanover Trust Company as indenture trustee are concerned, the court would, on careful review, ordinarily find that there was sufficient unchallenged and competent evidence to qualify them as legitimate charges *except* for the fact that, subsequent to the Penn Central's filing of its petition in reorganization while the Manufacturers Hanover Trust Company was acting as indenture trustee for the New Haven's First and Refunding Mortgage (from which position it resigned on June 21, 1971), it was required as indenture trustee for New York Central and/or Pennsylvania Railroad bonds to take certain actions *against* the interests of the estate of the New Haven Railroad in bankruptcy and did so. The circumstances were described in this court's opinion and order of August 20, 1975 in this case, which are repeated as follows:

> "It appears that Manufacturers, as indenture trustee for the New Haven's First and Refunding Mortgage,

was on December 31, 1968 also indenture trustee for 18 mortgages of the New York Central and/or the Pennsylvania Railroads then merged into the Penn Central Transportation Company. This circumstance produced no conflicts between the interests of the various bondholders until after the Penn Central filed its application for reorganization on June 21, 1970 and after the Supreme Court decision in the *New Haven Inclusion Cases* on June 29, 1970. In August, 1970 the New Haven reorganization court called for statements of position by the parties in interest relative to the remand ordered by the Supreme Court in the *Inclusion Cases.* There arose at that time an important issue in which the Manufacturers, as indenture trustee for the New Haven's First and Refunding Mortgage and represented by the Simpson, Thacher firm of attorneys, was sharply at odds with the Manufacturers, as indenture trustee of the New York Central and Hudson River Railroad Company Gold Bond mortgage [in which capacity the same trust company was] represented by the Kelley, Drye firm of attorneys. On June 21, 1971 Manufacturers resigned as indenture trustee for the First and Refunding Mortgage of the New Haven. As recently as July 21, 1975, the Manufacturers sought leave of the United States District Court for the Eastern District of Pennsylvania to resign as indenture trustee for New York Central and Hudson River Railroad Company Gold Bond mortgage dated June 1, 1897, because of potential conflict with its former position as indenture trustee for the New Haven mortgage. So far as is known, Manufacturers continues to act as indenture trustee for the 17 re-

maining mortgages. The Commission, therefore, will have before it for a finding, the factual issue of whether there has been and continues to be a conflict in interest on the part of the Manufacturers as former indenture trustee for the New Haven's First and Refunding Mortgage and as indenture trustee for the New York Central and/or Pennsylvania Railroad mortgages, and whether, if such conflict has existed, it has impeded or impedes in any way the New Haven reorganization."

The Manufacturers Hanover's petition to the Penn Central reorganization court to resign as indenture trustee for the New York Central and Hudson River Railroad Company Gold Bond Mortgage, dated June 1, 1897, was granted by the Penn Central reorganization court. It is undisputed that Manufacturers Hanover Trust Company is continuing to act as indenture trustee for each of the several bond issues of the New York Central and/or Pennsylvania Railroads which have interests contrary to those

—264—

of the estate of the New Haven Railroad in reorganization. Moreover, the Manufacturers Hanover Trust Company, as indenture trustee of the New York Central and/or Pennsylvania Railroad bond issues, is of the opinion that it still has a duty to assert, on behalf of the bondholders of those issues, claims contrary to the interests of the New Haven estate, so long as it is in the interests of and the desire of the New York Central and/or Pennsylvania Railroad bondholders to do so.

The court finds that after the filing by the Penn Central of its petition for reorganization on June 21, 1970 and the filing of the judgment of the Supreme Court in the *Inclusion*

Cases on June 29, 1970, the Manufacturers Hanover Trust Company, as indenture trustee for the New Haven Railroad's first mortgage bonds for nearly 25 years, 1941–1971, faced a conflict of interest with its position as indenture trustee for the New York Central and Hudson River Railroad Company Gold Bond Mortgage as well as it did with its position as indenture trustee for the 17 other New York Central and/or Pennsylvania Railroad bond issues. This was dramatized by the successful action which Manufacturers Hanover, as indenture trustee for the Gold Bonds, brought, through the attorneys for its trust department, Kelley, Drye, Warren, Clark, Carr & Ellis, against the New Haven reorganization trustee on the ground that the New Haven reorganization court lacked jurisdiction, on remand of the *Inclusion Cases* by the Supreme Court, to pass upon the secured status of the New Haven's claim for payment for the New Haven's sale and transfer of its operating property.

The evidence shows that the Chairman of the Board of Manufacturers Hanover Trust Company was of the opinion that the Trust Company had become disqualified to continue to act as indenture trustee for all of the bond issues in question, *i.e.*, both that of the New Haven and the 18 of the New York Central and/or Pennsylvania Railroads, and he so advised the appropriate officers of the Trust Company. The court is in entire agreement with that opinion. Although the Manufacturers Hanover, in apparent good faith, sought to resign from all of them and at the same time went to extraordinary lengths throughout the eastern United States to get qualified corporate banks to agree to act as successor indenture trustees, it was unable to do so. It did find a successor for the Gold Bond issue and on

September 4, 1975 the Manufacturers Hanover's resignation, as indenture trustee for the Gold Bonds, was accepted by the Penn Central reorganization court and the successor indenture trustee was appointed. The New Haven reorganization court ran into the same problem when, by the most diligent and thorough searches and inquiries by the Manufacturers Hanover Trust Company, Simpson, Thacher & Bartlett, its counsel, and the New Haven reorganization trustee(s) and their counsel no bank could be found to act as successor trustee for the New Haven's first and refunding mortgage bonds. Although the underlying mortgage itself specified that a successor trustee must be a qualified bank, the court, on the basic principle that it cannot permit a valid trust to fail for lack of a trustee, appointed Lawrence W. Iannotti, Esquire, a qualified practicing lawyer in New Haven, Connecticut, as successor indenture trustee under the first and refunding mortgage 4% bond issue of the New Haven Railroad. Later in January, 1972, when the Chase Manhattan Bank, N.A., resigned, because it was a creditor of the Penn Central, the court appointed Jacob D. Zeldes, Esquire, a qualified practising lawyer in Bridgeport, Connecticut, as successor indenture trustee under the New Haven Railroad's general mortgage (second series income bonds). This is not to suggest that a similar course should have been followed in the cases of the remaining 17 New York Central and/or Pennsylvania Railroad bond issues. For what it is worth, it is the opinion of this court that, considering the size and complexity of the Penn Central reorganization, such an arrangement would probably be entirely impractical. It is also understandable that those carrying on the reorganization proceedings of the Penn Central would probably not rise to

their feet with unanimous outbursts of enthusiasm to see 17 new successor trustees with 17 new counsel enter the ballpark. Nevertheless the prospect of more problems superimposed upon already existing ones of immense difficulty cannot operate to condone a breach of fiduciary duty or justify it.

Simpson, Thacher & Bartlett, as Manufacturers Hanover's counsel, argue there was no breach of fiduciary duty by the Trust Company for these reasons:

Where a bank, such as the Manufacturers Hanover Trust Company, is trustee under two separate trusts and the cestuis of the two trusts are on opposite sides of a controversy involving the interests of the trusts, the bank can avoid responsibility for a breach of fiduciary duty if it arranges to have counsel for one department of the bank appear in the controversy in the name of the bank, on the side of one cestui (the New Haven); and also arranges to have counsel for another department of the bank appear in the controversy in the name of the bank on the side of the other cestui (the Penn Central). In its reply brief it said,

> "Admittedly, a potential conflict of interest existed, which Manufacturers had already recognized and sought to avert. The essence of the problem Manufacturers faced was that it ran the risk of breaching its fiduciary duty to one group of bondholders or the other if it failed fully to represent their interests during the time before it could resign."

It, therefore, weighed the relative risks of liability if it took or appeared to take one side or the other between the two cestuis; its first solution was to assign one of its

lawyers to one side and another one of its lawyers to the other. The startling result was that, on opening court one morning, the New Haven reorganization court was handed a brief by the Simpson, Thacher firm from Manufacturers Hanover Trust Company for the New Haven side of the case, and it was then handed another brief by the Kelley, Drye firm from the Manufacturers Hanover Trust Company for the other side of the same case. This may have been (to adopt a remark by Prof. Freund) an exercise of the delicate art of threading that fine line "between partiality on the one hand and impartiality on the other." But it was not proper action by an indenture trustee. Manufacturers Hanover should have resigned from both, as its Chairman had said, but apparently no one felt the necessity of following through on his admonition. Even though the Manufacturers Hanover is a very large banking institution, it cannot be excused by saying that it was so large its right hand could not know what its left hand was doing nor could it be excused by doing through its attorneys, and agents what it was forbidden to do as a corporate person. Its next solution was to resign from the indenture of the New Haven and much later, after being granted leave by the Penn Central reorganization court, it resigned as indenture trustee for the Gold Bond mortgage bonds. Meanwhile it has continued as indenture trustee for the remaining New York Central and/or Pennsylvania Railroad bond issues.

In its capacity as the indenture trustee for these 17 issues, it asserts that it is its duty to oppose the claim of the New Haven reorganization trustee. Manufacturers Hanover's counsel in its brief makes reference to the New Haven reorganization trustee's citation of *Woods* v. *City*

National Bank & Trust Company of Chicago, supra, in support of the disqualification of Manufacturers Hanover Trust Company as indenture trustee for the New York Central and/or Pennsylvania Railroad bonds; but, as counsel for the Trust Company, Simpson, Thacher asserts that there was no breach of fiduciary duty, and says:

> "The [New Haven reorganization t]rustee's discussion of the conflicts question is based on *Woods* v. *City Nat'l Bank & Trust Co.,* 312 U.S. 262, [61 S.Ct. 493, 85 L.Ed. 820] (1941). As the Trustee notes, 'the essential basis for the disallowance of these claims by the reorganization court was that the claimants were pursuing interests of their own that were either of no benefit to the estate or, more often, were adverse to it.' (Trustee's Statement, at 24). *Woods,* therefore, is
> —266—
> inapposite since Manufacturers neither pursued any interest of its own nor pursued any interest adverse to the estate."

But it has "pursued [an] interest adverse to the New Haven estate" in pursuing the interests of the 18 New York Central and/or Pennsylvania Railroad indentures and it declares it has a duty to continue to do so. That is precisely what it has been doing over the past five years, and the *Woods* case declares it to be a breach of fiduciary duty. The law does not countenance such activity by a fiduciary—even an indenture trustee. *Woods* v. *City National Bank & Trust Company of Chicago, supra; In re Boston & Providence Corp., supra,* 260 F.Supp. at 422.

Too much, of course, should not be read into or inferred from such phrases as "breach of fiduciary trust" or "dis-

qualified . . . as indenture trustee". Such descriptive words do not say or imply that the Trust Company indulged in any conduct of a criminal nature or sought in any way to take or use other persons' property for its own use, or otherwise acquire any personal gain for itself. The Manufacturers Hanover Trust Company, through no action of its own, found itself in a position between conflicting interests, as to each of which it was in a position of indenture trustee. It could not help one without hurting the other.

The Trust Company, as indenture trustee for the New York Central and/or Pennsylvania Railroad indentures did speak of resigning but was dissuaded from doing so. It never took a strong stand for that proposition and never, when contemplating its dilemma, refused to serve, following this stand by pressing for or seeking an authoritative court declaration of its rights and duties, as it should have done.

While it is clear that the breach of fiduciary duty by the Manufacturers Hanover to the New Haven's first mortgage bondholders has impeded, and therefore damaged, the New Haven reorganization trustee's collection of the sums owed the New Haven estate from the Penn Central for the transferred properties of the New Haven and has frustrated the further development of a plan of reorganization for the New Haven, the extent of such damage cannot be ascertained at the present time. Its measure turns on the amount of money which the New Haven estate will receive in payment of the Supreme Court's judgment on the price to be paid by the Penn Central for the New Haven property. If the principal amount of that purchase price is paid in full, the damage from the Manufacturers Hanover's breach of trust would be trivial and de minimis. If no money were received by the New Haven

on the purchase price, the damage would greatly exceed the full amount of the Manufacturers Hanover claim for services and expenses. If the purchase price payment were ultimately to fall somewhere between nothing and the entire amount due under the terms of the judgment, the measure of the damage inflicted by the Manufacturers Hanover would go inversely up or down accordingly. The court finds that the Manufacturers Hanover Trust Company, as indenture trustee for the New Haven's First and Refunding Mortgage bonds, breached its fiduciary duty to the New Haven estate in reorganization and has damaged it. While *Woods* v. *City National Bank & Trust Company of Chicago, supra,* authorized a complete disallowance of fees for services and reimbursement of expenses, later cases in this Circuit and others have tempered this somewhat. See, *Berner* v. *Equitable Office Building Corp.,* 175 F.2d 218 (2 Cir. 1949); *Silbiger* v. *Prudence Bonds Corp.,* 180 F.2d 917 (2 Cir.), *cert. denied* 340 U.S. 813, 71 S.Ct. 40, 95 L.Ed. 597 (1950); *Chicago & West Towns Rys.* v. *Friedman,* 230 F.2d 364 (7 Cir.), *cert. denied* 351 U.S. 943, 76 S.Ct. 837, 100 L.Ed. 1469 (1956).

This court will allow Manufacturers Hanover Trust Company's claim for reimbursement of expenses in full. There has been no objection to them, qua proper expenditures, they are found to have been reasonable and necessary and they may be paid out of the debtor's estate in the amount of $103,018.34 as hereinafter directed.

In lieu of an absolute disallowance or reduction of the

—267—

Trust Company's petition for a *fee* for services as indenture trustee for the New Haven's First and Refunding Mortgage, the court will deal with its petition as follows:

The Trust Company's claim for services rendered in the

amount of $304,416.67, or any recoverable part of it, is ordered to be treated as contingent. The Manufacturers Hanover Trust Company is ordered to accept in full accord and satisfaction of the claimed sum and any and all claims for services, rendered by it as indenture trustee for the New Haven's First and Refunding Mortgage in any manner whatsoever, one-quarter (¼) of one per cent. (1%) of all payments made on and after the date of this judgment, to the New Haven estate in reorganization, for and on account of the purchase price, to be paid by the Penn Central for properties of the New Haven, as fixed by the judgment of the Supreme Court in the *Inclusion Cases*. Said payment of ¼ of 1% to the Manufacturers Hanover Trust Company shall in no event exceed $304,416.67 and no interest or other increments shall be added to this sum. In the event that the Manufacturers Hanover Trust Company declines so to accept whatever may accrue to it under the foregoing computation, the Trust Company's claim for services against the New Haven estate shall be disallowed in toto.[3]

3(a). *Simpson, Thacher & Bartlett,* counsel for Manufacturers Hanover Trust Company, July 7, 1971–August 30, 1971.

Simpson, Thacher & Bartlett's charges for attorneys' fees, July 7, 1971–August 30, 1971, are presented as expenses of the Manufacturers Hanover Trust Company as indenture trustee for the New Haven's First and Refunding Mortgage.

---

[3] This forfeiture provision is not intended to become operative simply through the taking of an appeal from the judgment by the Manufacturers Hanover Trust Company.

At the outset the court should call attention to the remarks made by the trustee for the debtor, in his statement of position, relative to the Simpson, Thacher firm's services in this matter, involving its client's breach of trust. They are as follows:

"If the Court considers Manufacturers' activities, in light of its conflict of interest, to warrant either disallowance or reduction of its fee, it is the Trustee's position that the Court should take into account that no question has ever been raised concerning the conduct of its counsel, Simpson, Thacher & Bartlett. Even though, as required under § 77(c)(12), the petitioner is Manufacturers, rather than its counsel, and even though counsel can theoretically look to the client for payment, as a practical matter, a reduction in the amount allowed as reimbursement for legal fees is likely to impact persons who, in the Trustee's view, have benefited the Estate and as to whom no misconduct has even been intimated." (Footnote omitted.)

Although the court disagrees with the conclusions reached by counsel for the Manufacturers Hanover Trust Company in its brief that there were sufficient reasons given by the Trust Company to excuse it from a charge of breach of its fiduciary duty as indenture trustee for the New Haven's First and Refunding Mortgage bonds, it does agree with the statement by the New Haven reorganization trustee relating to the Simpson, Thacher firm. Such deductions as are made from the firm's statement of its services to the New Haven estate are for reasons which are in no way connected with any breach of fiduciary trust by the Manufacturers Hanover Trust Company.

The evidentiary material presented on behalf of the firm by Horace McAfee, Esquire, a senior partner, in his affi-

davit gave an excellent general narrative account of its participation in the reorganization proceedings of the New Haven Railroad from their inception on July 7, 1961 to August 30, 1971. With this account there was attached a thorough, detailed appendix which particularized everything done by the Simpson, Thacher firm as counsel to the indenture trustee for the New Haven's First and Refunding Mortgage bonds.

—268—

In general, the law firm of Simpson, Thacher & Bartlett, as counsel for the indenture trustee, attended and participated in every court hearing (other than a few which were simply routine), which concerned the reorganization of the New Haven Railroad. They also represented the indenture trustee in the hearings before the three-judge court in the Southern Distict of New York and at the hearings held by the special master on the valuation of the Grand Central Terminal Properties.

From time to time they met and conferred with the reorganization trustees or trustee and their counsel on various problems in the reorganization, including financing (such as Trustees Certificates), tax problems, leasing of cars and equipment, opposing harmful proposed amendments to New York State tax laws, sales of pieces of property subject to the mortgage of which Manufacturers Hanover Trust Company was indenture trustee, involving partial releases from the mortgage and the application or use of the proceeds, work on a plan of reorganization of the Boston and Providence Railroad, representation of the indenture trustee in aid of the New Haven estate in reorganization concerning certain abandonment proceedings and an effort to discontinue the costly New Haven Railroad passenger service, including a hearing before an I.C.C. hearing examiner.

With the reorganization trustees of the New Haven, and cooperation of the United States Trust Company, as indenture trustee for the Harlem River Division Mortgage, Simpson, Thacher played a very active and important role including judicial proceedings before this court, the United States Court of Appeals for the Second Circuit and petitions for certiorari to the Supreme Court, in barring the high priority claims of "six months" creditors of the New Haven, including per diem claims for a total of approximately $6,000,000.

After the reorganization trustees of the New Haven had negotiated a tentative contract with the officers of the Pennsylvania and New York Central Railroads, which were seeking to merge, pursuant to which the New Haven reorganization trustees were to turn over the transportation plant of the New Haven Railroad to the merged railroads for approximately $125,000,000, subject to the approval of the New Haven reorganization court, the Pennsylvania and New York Central Railroad negotiators requested and were given to understand that the New Haven reorganization trustees would not seek an increase in the amount of the consideration to be paid by the merged Pennsylvania and New York Central Railroads. The New Haven reorganization trustees had thus established a beginning and a foundation for an inclusion price. The agreement never came before the reorganization court for approval and it was routinely sent along to the I.C.C. for initial study and action. All of the petitioners (or their predecessors, as the case may be) took the position that the consideration moving to the New Haven estate was wholly inadequate. As the New Haven reorganization trustees felt disqualified to seek changes in the tentative contract be-

cause of their understanding with the negotiators (a position which the court understood and expressly approved), the court left it entirely in the hands of the petitioners (or their predecessors), at the time, to oppose the contract and seek a larger payment or price for the property of the New Haven. This involved pressing for disapproval of the agreement by the I.C.C. which that body denied, hearings before the three-judge court in the Southern District of New York, a lengthy trial on review in the reorganization court, followed, after a grant of certiorari, by briefing and arguments before the Supreme Court. As counsel representing the indenture trustee for the New Haven's First and Refunding Mortgage bonds, Simpson, Thacher pulled the laboring oar in presenting the case before the Commission in the lower courts, and particularly in the Supreme Court. The senior partner of Simpson, Thacher & Bartlett prepared the brief and made the principal argument before the Supreme Court. He was ably seconded by the arguments of Attorney Migdal for the Bondholders Committee, and by Attorney Auerbach, special counsel to the

—269—

reorganization trustee. Attorney Bushby of Dewey, Ballantine, Bushby, Palmer & Wood, prepared and filed an excellent brief.

The decision of the Supreme Court fixed the price to be paid for the New Haven properties at $174,600,000. The difference between this amount and approximately $125,000,000, *i.e.* $49,600,000, is roughly what the petitioners claim is the portion of the judgment attributable to their efforts except, they say, that there should be credited to them errors in the I.C.C. computation which three of them discovered. (1) The Dewey, Ballantine firm, counsel for Chase Manhattan Bank, N.A., spotted a double counting

by the I.C.C. of $16.2 million paid in taxes; (2) the Simpson, Thacher firm, as counsel for Manufacturers Hanover Trust Company, discovered that cost of liquidation had not been discounted to present value, resulting in an understatement of $3,800,000; and (3) the Carter, Ledyard firm found there was an error in the New Haven estate's appraiser's valuation of the Bronx freight yards, resulting in an underappraisal of $4,600,000. Disclosure of these errors in the I.C.C. valuation determination added $24,600,000 to its computation and to the difference between the first I.C.C. valuation and the ultimate price fixed by the Supreme Court.

Another achievement to which Simpson, Thacher & Bartlett contributed was the holding by the Supreme Court that the shares of stock of the Penn Central, to be used in partial payment to the New Haven Railroad, particularly in the light of Penn Central's filing for reorganization under § 77, was substantially overvalued for the purpose of "underwriting" the purchase price as ordered by this court and that part of the case was remanded "to determine the form that Penn Central's consideration to New Haven should properly take and the status of the New Haven estate as a shareholder or creditor of Penn Central." *New Haven Inclusion Cases, supra,* 399 U.S. 392, at 489, 90 S.Ct. 2054, at 2108, 26 L.Ed.2d 691.

The foregoing illustrative high points of the services rendered by the Simpson, Thacher firm, if studied in connection with the thorough review of the history of the New Haven reorganization proceedings, contained in the Supreme Court opinion in the *New Haven Inclusion Cases,* will reveal the complexity and, to a degree the novelty of the wide variety of issues with which the firm was required to deal.

The detailed account of the part it played and the contribution it made to the reorganization proceedings, are well set out in the affidavit of Horace J. McAfee, Esquire, and the attached appendix, as mentioned above. The court finds that the matters therein recited and the representations made are true and correct and that the fair and reasonable value of their services as counsel to Manufacturers Hanover Trust Company as indenture trustee for the New Haven's First and Refunding Mortgage bonds is $808,000, plus such contingent addition as may later eventuate in accordance with a provision hereinafter recited.

• • • • •

—273—

ORDER SUPPLEMENTING AND CLARIFYING THIS COURT'S OPINION OF JUNE 30, 1976

The Manufacturers Hanover Trust Company having filed a petition for clarification of this court's opinion, and certain respondents having filed answers and objections thereto, and all parties in interest having been duly notified of said petition and of the time and place assigned for hearing thereon, and having been heard or having been given an opportunity to be heard, this court now supplements and clarifies its opinion as follows:

The allegedly unclear portion of the court's June 30, 1976 opinion concerns the interpretation and application of two sentences on page 266 which are: "Too much, of course, should not be read into or inferred from such phrases as 'breach of fiduciary trust' or 'disqualified . . . as indenture trustee'. Such descriptive words do not say or imply that the Trust Company indulged in any conduct of a criminal nature or sought in any way to take or use

other persons property for its own use, or otherwise acquire any personal gain for itself." It still seems obvious that the intent and purpose of these sentences were to forfend against the drawing of extreme and unjustified inferences by any of the parties in interest and by the general public against this petitioner by equating the phrase "breach of fiduciary trust" with criminal conduct such as embezzlement and larceny or with civil conversion or misappropriation of the trust res or a part of it. The above quoted two sentences were included in the opinion for the purpose above stated and no other. They are wholly irrelevant to any claim of failure on the part of the petitioner fully to carry out its equitable duties and obligations, or any consequences thereof, as Indenture Trustee for the New Haven bonds. The issues before the court at the time

—274—

the decision of June 30, 1976 was rendered, concerned only the compensation of the petitioners and the reimbursement of their expenditures.

The petitioner plainly breached its fiduciary duty to the New Haven Railroad in reorganization and for five years has continued to do so. It has expressly stated its intention to adhere to this position in the future and to oppose and contest the claim of the New Haven estate in reorganization that the purchase price due for the New Haven's property, based upon the Supreme Court's judgment against the Penn Central in the *Inclusion Cases,* is secured by an equitable lien. For the past three years, at least, the petitioner has made no genuine effort to resign as Indenture Trustee for the remaining 17 bond issues for which it is still Indenture Trustee. In the light of all of these circumstances this court was unable to make an outright, unconditional award of compensation for services rendered the

New Haven estate by the petitioner and therefore made it contingent for obvious reasons.

This court in the proceedings on the petitions for compensation and the judgment of June 30, 1976, did not adjudicate any past or future claim for damages based upon a breach of fiduciary trust on the part of the Manufacturers Hanover Trust Company as indenture trustee for the First and Refunding Mortgage Bonds of the New Haven Railroad; and the finding of such a breach was made solely for the purpose of disclosing the reason underscoring the contingent nature of and the amount and time of payment of compensation, if any, which might become payable to the Trust Company. It was not intended to constitute a bar to any defense the Trust Company might interpose in an action for damages against it in any possible future litigation concerning its responsibilities as indenture trustee to the estate of the New Haven Ralroad in reorganization.

The court retains and continues to retain jurisdiction over the issues in this case and affirms its judgment of June 30, 1976, discussed herein. It is so ordered.

Excerpts of Testimony of Robert A. Byrne, Vice-President of Manufacturers

(Transcript, May 18, 1976)

• • • • •

Cross Examination by Professor Moore:

• • • • •

Q. Well, Manufacturers did have a conflict of interest, did it not, after at least Penn Central went into reorganization? A. On June 20, 1970 when the Penn Central filed for bankruptcy, we then felt that there was a potential conflict at that time. Yes, sir.

Q. And you say "potential". When did it in your mind become actual? A. Well, we did the best we could. We thought we were insulating ourselves from a conflict of interest in that we assigned or retained separate counsel to represent us in the Penn Central proceeding, Kelley, Drye, Newhall and Cornelius, and Simpson, Thacher and Bartlett in the New Haven proceedings. (Tr. 17-18)

• • • • •

Redirect Examination by Mr. Bader:

Q. Let me ask you a question. Prior to August 10, 1970, had any discussions taken place within Manufacturers Hanover Trust Company as to whether or not Manufacturers Hanover should resign because there was a potential conflict of interest? A. Yes. There was.

Q. Do you recall what directive was issued by the Chairman of the Board of Manufacturers Hanover Trust? A. The Chairman directed that it resign immediately.

Q. From what mortgages? A. All mortgages.

Q. That is to say, all the Penn Central mortgages and the New Haven mortgage; is that correct? A. Yes. That's correct.

The Court: And when did he do that?

The Witness: Just shortly after the Penn Central went into reorganization in 1970.

Mr. Bader: In the month of July, Your Honor, Mr. McAfee was present at the meeting and I can testify on that point if you wish.

The Court: Yes. Well, he can go ahead and testify as far as that goes.

The Witness: It would be in July, 1970.

The Court: That was to resign from all their positions as indenture trustee for the old New York Central bonds and from the New Haven?

The Witness: (Witness nods head.)

The Court: What happened after that?

The Witness: Well, it was impractical. As a practical matter, we couldn't do it. We felt we couldn't resign, leave the Bondholders without any trustee, first of all, and then we proceeded to canvass banks throughout the country to take over this business, and we were unsuccessful. (Tr. 24-26)

• • • • •

Recross Examination by Professor Moore:

Q. Mr. Byrne, were you advised whether or not you could petition Judge Anderson and Judge Fullam to have special counsel or special trustee appointed?

Mr. Bader: Could I hear the question?

(The previous question was read back by the Reporter.)

Mr. Bader: Could we fix this as to time?

Professor Moore: Any time.

Mr. Bader: Well, I think the only real issue is between July 1 and August 10, and I don't think it would have been feasible then—I think it's pertinent what time we are talking about.

The Court: Well, I think it's a proper question as far as any time after the Penn Central went into bankruptcy. From then to the present. At any time there was no petition to me that I recollect with regard to them.

The Witness: No, sir.

The Court: And, of course, I would have no authority over them because they're all New York Central bonds, and I take it that would come before Judge Fullam in the Eastern District of Pennsylvania.

The Witness: And I answer your question no.

The Court: Was a petition made to him relative to the appointment of substitute trustee—

The Witness: No, sir.

The Court: —special master or anything of that sort to fill in where you felt you should resign or at least your Chairman of the Board should decide?

The Witness: No special, no.

The Court: Was anything done outside of the contacting the 62 banks with a view to asking them to step in as indenture trustee? Was anything else done?

The Witness: No. There wasn't.

The Court: You didn't take the issue up with the Court at all?

The Witness: No.

The Court: When you found they wouldn't take it, you couldn't find any bank to take it, you just kept on going? I mean the Manufacturers are still acting as indenture trustee—

The Witness: Yes.

The Court: —for those bonds?

The Witness: Yes. (Tr. 30-32)

• • • • •

Cross Examination by Mr. Zeldes:

• • • • •

Q. As I understand it, the bank as a trustee came to the conclusion that they could insulate the problem by hiring two separate counsel; is that correct? A. Yes.

Q. And did you receive the permission or the consent of either this Court or the Reorganization Court in Pennsylvania to approve that insulation theory that you adopted? A. No, we did not.

Q. Now, can you tell me, please, who the officials were in the bank who dealt with the lawyers in the various states? Were there many people involved? A. Many people, yes, sir.

Q. And were those the people that also dealt with Kelley, Drye, Newhall and Cornelius, the firm that you hired in connection with the Penn Central? A. Yes, sir. (Tr. 33-34)

• • • • •

Q. One of the points you mentioned on direct to Mr. Bader was that you in setting the fee as you did as trustee, you were concerned with the novelty of the issues involved. I assume, therefore, when you came upon this insulation theory, you consulted counsel on this theory; is that correct? A. Yes.

The Court: Which counsel?

The Court: Well, we have talked to each counsel separately.

By Mr. Zeldes:

Q. And did they both—I'm sorry, Your Honor.

The Court: Go ahead.

Q. When you consulted with both of these counsel separately, did they give you the same advice with respect to the insulation theory? A. It's the best we could do, yes.

Q. But they both gave you the same advice; is that correct? A. Yes. (Tr. 37-38)

• • • • •

Q. Let me ask you this then. What is the bank's understanding with respect to compensation for your lawyers in this proceeding in the event that the Court should not award any out of the estate? A. Well, I think we would then discuss it.

Q. Pardon? A. I think then we would discuss it. We have not reached an agreement or an understanding on that point. I think this would be—

Q. Do you agree with the statement that your lawyer just made that you are under a moral obligation to pay them if that occurs? A. I think we would.

The Court: You would what, have the obligation or would pay them?

The Witness: We would pay them. (Tr. 40-41)

IN THE

Supreme Court of the United States

October Term, 1976

No. 76-1794

IN THE MATTER OF THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, Debtor

JACOB D. ZELDES, Successor Indenture Trustee Under The New York, New Haven and Hartford Railroad Company's General Income Mortgage Dated as of July 1, 1947,

Petitioner,

v.

MANUFACTURERS HANOVER TRUST COMPANY, Former Indenture Trustee Under The New York, New Haven and Hartford Railroad Company's First and Refunding Mortgage Dated as of July 1, 1947; and

RICHARD JOYCE SMITH, Trustee of the Property of The New York, New Haven and Hartford Railroad Company, Debtor,

Respondents.

BRIEF OF RESPONDENT MANUFACTURERS HANOVER TRUST COMPANY IN OPPOSITION

WHITNEY NORTH SEYMOUR
Counsel for Respondent
Manufacturers Hanover Trust Company
One Battery Park Plaza
New York, New York 10004

ALBERT X. BADER, JR.
WILLIAM K. BLOMQUIST
SIMPSON THACHER & BARTLETT,
Of Counsel.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

IN THE

Supreme Court of the United States

October Term, 1976

No. 76-1794

—0—

IN THE MATTER OF THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, Debtor

---

JACOB D. ZELDES, Successor Indenture Trustee Under The New York, New Haven and Hartford Railroad Company's General Income Mortgage Dated as of July 1, 1947,

Petitioner,

v.

MANUFACTURERS HANOVER TRUST COMPANY, Former Indenture Trustee Under The New York, New Haven and Hartford Railroad Company's First and Refunding Mortgage Dated as of July 1, 1947; and

RICHARD JOYCE SMITH, Trustee of the Property of The New York, New Haven and Hartford Railroad Company, Debtor,

Respondents.

—0—

BRIEF OF MANUFACTURERS HANOVER TRUST COMPANY IN OPPOSITION

Preliminary Statement

This brief is submitted on behalf of Manufacturers Hanover Trust Company ("Manufacturers") in opposition to the Petition for Certiorari filed by Jacob D. Zeldes, Successor Indenture Trustee under the General Income

Mortgage of The New York, New Haven and Hartford Railroad Company ("New Haven") to review a unanimous decision of the Court of Appeals for the Second Circuit which affirmed, so far as appealed, a decision of the District Court for the District of Connecticut, sitting as a Court for the Reorganization of a Railroad under Section 77 of the Bankruptcy Act, 11 U.S.C. § 205, determining fees and allowances, including attorneys' fees of certain trustees and former trustees.

Counterstatement of Questions Presented

The opinion of the Court of Appeals accurately sets forth the questions presented:

> (1) "Whether the New Haven reorganization court as a court of equity, had the authority, absent a specific statutory directive to the contrary, in the exercise of its discretion to allow or to deny compensation and expenses, including attorneys' fees, to an indenture trustee which concededly represented conflicting interests under very unusual circumstances; and
>
> (2) if so, whether the reorganization court exercised sound discretion in allowing the compensation and expenses in question" (App. 3a).*

*For convenience, we refer to record references in the following fashion:

References to the appendix attached to the Petition for Certiorari are cited as "App. a."

References to the Petition for Certiorari are cited as "Pet. ."

References to the Joint Appendix on Appeal to the Second Circuit are cited as "Jt. App. A ."

Counterstatement of the Case

A clear and orderly statement of the facts pertinent here is found in the decision of the Court of Appeals (App. 3a-14a). However, because of certain errors in the Petition, and to acquaint the Court with the most important elements of the "unusual circumstances" emphasized by the Court of Appeals, the following points are noted here:

First, Petitioner persists in asserting that the Court of Appeals had no grounds for its unequivocal findings that Manufacturers made every possible effort to extricate itself from a sudden, unexpected and involuntary conflict situation and fully informed the Reorganization Court, which had supervised the New Haven reorganization from the beginning, of its predicament (Pet. 8-9; App. 8a, 28a-29a). The situation arose when, eight days before this Court's decision in the *New Haven Inclusion Cases*, 399 U.S. 392 (June 29, 1970), the Penn Central Transportation Company (Penn Central)* filed its petition for reorganization in the District Court in Philadelphia.

After careful consideration, the Court of Appeals unanimously approved the Reorganization Court's exercise of its plenary discretion which Petitioner here challenges anew. Petitioner again asserts (Pet. 10, fn. 3) that there is no evidence to support Manufacturers' statement that it had informed both the New Haven and Penn Central reorganization courts" (Court of Appeals Opinion, App. 8a) of the conflict situation when it suddenly arose. As was pointed out to the Court of Appeals, this erroneous assertion completely ignores the sworn statements of Horace J. McAfee (dated June 12, 1975), a senior partner of the firm representing Manufacturers, which was part of

* The surviving entity after the merger of the Pennsylvania Railroad Company (Penn) and the New York Central Railroad Company (Central).

Manufacturers' application for an allowance, that (1) in July 1970, he advised counsel for the New Haven Reorganization Trustee and then the Trustee himself that Manufacturers had a potential conflict of interest because of its trusteeships of the New Haven and the Central, and would seek a qualified successor and resign, and asked the Trustee's counsel to so inform the Reorganization Court, and that (2) in September 1970, Mr. McAfee spoke with Judge Anderson about Manufacturers' decision to resign because of the conflicts and about its efforts to find a successor (Jt. App. A 220-221).* Mr. McAfee was tendered on two occasions for cross-examination at a hearing before the Reorganization Court on May 18, 1976, at which Petitioner was present (Jt. App. A 365-366, 382). Petitioner had no questions for Mr. McAfee and did not question his affidavit. Thus, the record completely supports the Court of Appeals' finding on this matter.

Second, Petitioner ignores the facts, fully supported in the record below and specifically found by the Court of Appeals, that immediately after Penn Central's bankruptcy, on June 21, 1970 Manufacturers, realizing the potential for conflict in its situation, took immediate action to find a qualified successor trustee for the New Haven's First Mortgage and resign (App. 8a).

The record is clear that Manufacturers promptly undertook an exhaustive search for a corporate trustee qualified to succeed it under the New Haven First Mortgage. The broad scope of that search was well known to the Reorganization Court (Jt. App. A 510) and was acknowledged by the Court of Appeals (App. 8a).

When it became apparent in the spring of 1971 that, despite these efforts, it was unlikely that any qualified

* Indeed, the Reorganization Court noted that it had itself tried to find qualified corporate successor trustees without success.

corporate successor trustee free from conflicts similar to those of Manufacturers and willing to undertake the trust could be found, the Reorganization Court, at Manufacturers' request, directed the appointment of a successor individual trustee in order that the trust of the New Haven First Mortgage might not fail for want of a trustee.

Upon the confirmation of Mr. Iannotti as successor trustee, any brief conflict which might have existed with respect to Manufacturers terminated since all fiduciary obligations* of Manufacturers to the New Haven *cestuis* ceased. Thereafter, Manufacturers had no further participation in the New Haven reorganization proceedings, except in matters relating directly to its fee application. Thus, Petitioner's assertions based on the existence of a continuing conflict are groundless.

Third, it is not the case, as Petitioner would have it, that "Manufacturers . . . had hired two counsel who had taken directly conflicting positions on the central issue facing [sic] reorganization. . . ." (Pet. 4). Manufacturers Trust Company, whose general counsel was Simpson Thacher & Bartlett ("Simpson Thacher"), and who served as trustee under the New Haven's First and Refunding Mortgage since 1947, merged in September 1961 with The Hanover Bank ("Hanover"). Hanover, whose counsel was Kelley Drye & Warren (as it is now known), had since the 1890's served as trustee under various Central mortgages. Thus, these representations were inherited, not confected.

When it was suddenly faced, by reason of the Reorganization Court's order and notice of August 10, 1970, with important questions relating to the reorganization of

* Other, of course, than a continuing obligation not to make any improper use of its former fiduciary position, an act of which there has been not the slightest suggestion during the course of these proceedings. See *Restatement (Second) of Trusts* § 170, comment g (1959).

the New Haven and of the Penn Central, rather than default in its then existing obligations to each group of *cestuis,* Manufacturers instructed both of its counsel to espouse positions which were in the best interests of each group of *cestuis.* To the extent that there was any alleged conflict in that brief period before the New Haven trusteeship could be responsibly resigned, it was a conflict in legal positions taken by counsel in papers publicly filed with the New Haven Reorganization Court, which ultimately decided in favor of the position of the New Haven representatives.

This was not a controversy between Manufacturers and Manufacturers, as Petitioner would have it. It was one between the New Haven interests (which sought an equitable lien and constructive trust and supported the jurisdiction of the New Haven Reorganization Court) and the Penn Central interests (which opposed the equitable lien and constructive trust and opposed the New Haven Court's jurisdiction). Each position was upheld by numerous well qualified and capable counsel. The fight was in the open; it was waged through filed briefs and at public hearings before the courts. The Court of Appeals was fully familiar with the controversy and all its implications for it ultimately reversed the Reorganization Court's decision, and sustained the Penn Central's position. *In re New York, New Haven & Hartford R.R.,* 457 F.2d 683 (2d Cir.), *cert. denied,* 409 U.S. 890 (1972).

Thus, in contrast to Petitioner's implication, the involvement of different counsel representing two different viewpoints in the New Haven reorganization proceedings in the second half of 1970 was the fortuitous result of historical allocations of work among counsel.* This sudden dilemma

* The Court of Appeals commented, "Indeed, the availability of separate counsel already representing each side was the single positive fortuity in this very difficult situation." (App. 30a, fn. 24)

was resolved in the only practical manner, and there was no departure from the most conscientious standards of fiduciary responsibility.

Reasons for Denying the Writ

Summary

As the Court of Appeals recognized, this is a unique case, and one singularly appropriate for resolution by a "wise and comprehending chancellor" (App. 3a). Because of the Penn Central bankruptcy, Manufacturers, which had for almost 10 years labored single-mindedly on behalf of the *cestuis* of the New Haven mortgage, suddenly found itself also obligated to act as a fiduciary for the contrary interests of the *cestuis* of Central mortgages. This unique dilemma was, as recognized by the Court of Appeals, wholly involuntary and due to no fault of Manufacturers.

While it was seeking to find qualified successors and then to resign, Manufacturers was obligated to represent these competing interests in a litigation which was then on-going. It made no secret of what it was doing or of the problem it faced; it so advised both reorganization courts and both sets of reorganization trustees. It authorized each of its counsel to take the necessary legal steps to defend the respective interests of the *cestuis* they represented, while it proceeded with its efforts to find those successors and resign.

Contrary to Petitioner's assertion, this case presents no broad question of federal bankruptcy policy. The Reorganization Court's decision, which the Court of Appeals unanimously affirmed, was a careful exercise of its traditional discretion as a court of equity on the specific facts before it. It reflects no error or abuse of authority, in

light of the special facts with which the courts below have dealt. The result is plainly equitable and correct.

As to the alleged conflict between the decisions below and those of this Court and of other Courts of Appeals, none has been shown. Rather, the cases reflect a consistent recognition of the well-settled principle that a reorganization court, as a court of equity, has discretion, absent an explicit statutory mandate to the contrary, to allow or to deny compensation and reimbursement to trustees and their counsel.

I. There Has Been No Showing of an Abuse of Discretion by the Reorganization Court in its Careful Exercise of the Traditional Powers of a Court of Equity.

As soon as it became apparent to senior management of Manufacturers in July 1970 that, upon the filing of Penn Central's petition for reorganization, Manufacturers faced a unique dilemma between its duties as the New Haven Indenture Trustee and its duties as Indenture Trustee for Penn Central mortgages, the bank immediately commenced steps, consistent with its obligations to all its *cestuis,* to take orderly and appropriate action to resign. However, realizing that it would be improper arbitrarily and summarily to cease carrying out its fiduciary functions for its New Haven and Penn Central *cestuis,* Manufacturers did three things: (1) it advised both Reorganization Courts that it had a conflict which it intended to cure by resigning as soon as it could find qualified successors; (2) it embarked upon an active search for such qualified successors; and (3) through its respective counsel it continued to represent the positions of the respective *cestuis.*

Nevertheless, according to Petitioner, any conflict—however brief, however technical, however involuntary—worked an immediate forfeiture of any and all compensation. Judge Timbers, writing for a unanimous Court of Appeals, totally rejected these contentions of Petitioner, pointing out that Manufacturers

> ". . . had no sooner conceived the idea to resign than its attorneys, on both sides, advised that it could not resign without leaving the bondholders stranded. Thus, on the advice of both of its firms of attorneys, Manufacturers chose the best *possible* alternative. . . ." (App. 29-30a, emphasis in the original).

We respectfully submit that Petitioner has misinterpreted the applicable provisions of trust law in his analysis of Manufacturers' obligations to its New Haven *cestuis.* Judge Anderson has exercised uninterrupted judicial supervision of the New Haven reorganization for a period of more than sixteen years. It is beyond dispute that he is intimately familiar with these proceedings and in the best position to have judged the propriety of the actions by Manufacturers.

After a consideration of voluminous supporting material and based upon its knowledge of the facts, the Reorganization Court made the awards challenged here. As the Court of Appeals pointed out, to reach the contrary conclusion urged by Petitioner would ". . . strip the reorganization court as a court of equity of its authority to exercise sound discretion" and ". . . would render equity inequitable." (App. 15a). We do not believe that Manufacturers, having involuntarily and through no fault of its own (as has been concluded by both courts below) found itself in an impossible situation, was obligated to throw up its hands and do nothing to protect its *cestuis* to avoid endangering its just compensation for ten years of diligent service prior to that time. To the contrary, we submit that

had Manufacturers abandoned its fiduciary obligations it might have exposed itself to proper censure by the Reorganization Court. The nature and value of the services rendered during those ten years are fully set forth in the record, cf. Jt. App. A 516-A 520; no one questions them. Judge Anderson applied what he regarded as a proper penalty for the conflict he found by making Manufacturers' compensation contingent. No equitable considerations suggest that a reorganization court should not have such discretion or that it was abused here.

II. The Decision Below Does Not Conflict With Either This Court's Decision in the *Woods* Case or with Decisions of Other Courts of Appeals.

Petitioner argues that the decisions below are in conflict with *Woods* v. *City National Bank & Trust Co.*, 312 U.S. 262 (1941) because, in his view, *Woods* requires automatic disallowance of fees and expenses whenever a reorganization court finds conduct which it characterizes as involving a "conflict of interest" or "breach of trust". As the Court of Appeals recognized (App. 16a-19a), this was not the holding of *Woods*. *Woods* reinstated a decision of a reorganization court exercising its discretion to deny allowances to self-dealing trustees and their self-dealing counsel.

As the Court below noted, the fact pattern in *Woods* was:

> ". . . in sharp contrast to that in the instant case. There, claims for compensation were filed by an indenture trustee, the members of a bondholders' committee, and the committee's counsel. The bondholders' committee, originally organized by the indenture trustee, included employees of the indenture trustee's corporate reorganization department as

well as employees of an underwriter heavily interested in the debtor's stock and under threat of suit for defrauding the bondholders. The same firm of attorneys which had been retained by the indenture trustee was employed by the committee. Thus the interlocking personnel of the committee and the indenture trustee represented the depositing bondholders who were interested in having a low upset price fixed for the debtor's property, the nondepositing bondholders who were interested in a high upset price, and a large stockholder who sought a favorable position in the reorganization at the expense of both. The essential ground upon which the reorganization court disallowed the claims for compensation was that the claimants were pursuing interests of their own that were either of no benefit to the estate or were adverse to it." (App. 17a, fn. 14)

This Court noted in *SEC* v. *Chenery Corp.*, 318 U.S. 80, 89 (1943) that:

> "Woods v. City Bank Co., 312 U.S. 262, held only that a bankruptcy court, in the exercise of its plenary power to review fees and expenses in connection with a reorganization proceeding under Chapter X of the Chandler Act, 52 Stat. 840, could deny compensation to protective committees representing conflicting interests."

Cf., with respect to the broad equitable power of a bankruptcy court, *American United Mutual Life Ins. Co.* v. *City of Avon Park*, 311 U.S. 138, 146 (1940); *SEC* v. *United States Realty & Improvement Co.*, 310 U.S. 434, 455 (1940).

The Second Circuit in *Berner* v. *Equitable Office Bldg. Corp.*, 175 F.2d 218 (2d Cir. 1949) and *Silbiger* v. *Prudence*

Bonds Corp., 180 F.2d 917 (2d Cir. 1950), consistent with the teachings of *Woods*, has recognized the power of a district court, in its discretion, to grant or deny fees to a fiduciary in a reorganization proceeding who had acted disloyally (in *Berner*, an attorney who had disclosed inside information; in *Silbiger*, an attorney who had represented two classes of bondholders, whose interests conflicted). In the latter case, this Court denied a petition for certiorari filed by the Trustee and supported by the SEC, *sub nom. Prudence Bonds Corp.* v. *Silbiger*, 340 U.S. 831 (1950), alleging, *inter alia*, that that decision was in conflict with *Woods*.* See also *Chicago & West Towns Rys.* v. *Friedman*, 230 F.2d 364 (7th Cir.), *cert. denied sub nom. Elward* v. *Friedman*, 351 U.S. 943 (1956), where the court found a conflict of interest which petitioning attorneys had taken some trouble to conceal. The court affirmed a reduced award, saying (230 F.2d at 369):

> "Authority exists for the disallowance of all fees [citing *Woods*]. But in several reorganization cases a less harsh rule has been adopted. A penalty of less than full forfeiture was approved in [*Silbiger* and *Berner*]. We may decide the extent of the penalty."

Clearly, Judge Anderson understood that upon deciding there had been a conflict of interest, he was empowered in the exercise of his discretion to *deny* compensation. Neither *Berner* nor *Silbiger* questions that power. What they do recognize, as did Judge Anderson, is that a chancellor having a view to all of the circumstances, may, in his discretion, *award* compensation and apply limits which his

* Petitioner cites only 340 U.S. 813, where this Court denied the attorney's petition.

discretion may suggest. So, we submit, do the other Courts of Appeals.*

In re Midland United Co., 159 F.2d 340 (3d Cir. 1947), cited by petitioner (Pet. 23) as indicating a contrary view on the part of the Third Circuit, in fact deals with transactions specifically prohibited under Section 249 of the Bankruptcy Act. Discussing *Woods* and *American United Mutual Life Insurance Co.* v. *City of Avon Park, supra*, the court stated:

> "They hold, as already pointed out, that the bankruptcy court had plenary power to deny compensation to a fiduciary in a reorganization proceeding 'where an actual conflict of interest exists' regardless of whether 'fraud or unfairness' resulted." 159 F.2d at 346.

Finding that there was such a conflict, the Circuit Court affirmed the decision of the District Court to deny compensation.

In *Carey* v. *Selected Investments Corporation*, 319 F.2d 578 (10th Cir. 1963) cited by Petitioner (Pet. 22) as being in conflict with the Second Circuit's decision here, the Tenth Circuit noted,

> "Section 241 of the Bankruptcy Act . . . provides in presently pertinent part that the judge may allow reasonable compensation to the attorney for the debtor. Under such grant, the court has implied plenary power to review a claim for services of that kind and to disallow it if the attorney at the time of the rendition of the services also represented

* Instructively, Petitioner has never previously referred to any of the decisions of Courts of Appeals he now claims are in conflict with the decisions below.

another party or parties having interests in conflict with those of the debtor'',

citing *Woods,* 319 F.2d at 580, and thereupon affirmed the determination of the District Court denying compensation. Thus, both the Third and the Tenth Circuits, contrary to Petitioner's claim, are consistent with the Second and Seventh Circuits in recognizing the discretion of the Reorganization Court to grant, modify or deny compensation when faced with a conflict of interest or a breach of trust.

Young v. *Potts,* 161 F.2d 597 (6th Cir. 1947), was an action for an accounting against a stockholder-lawyer who had taken an appeal on behalf of a class of stockholders and then sold his shares and the appeal for a substantial premium. In a subsequent accounting action, he sought to credit against the judgment for the premium his expenses and those of his law partner incurred in taking the appeal he had sold. While it is not clear from the opinion whether the decision of the Sixth Circuit disallowing any credit for fees and expenses was based upon the fact situation there presented, upon the absolute proscription in Section 249 of the Bankruptcy Act, 11 U. S. C. § 649, discussed *infra,** or upon the court's construction of the *Woods* and *Avon Park* cases, *Young* v. *Potts,* an obvious self-dealing case, is plainly not applicable to the facts here.

---

* Petitioner's quotations from *Young* v. *Potts* (Pet. 22) clearly relate to the court's discussion of Section 249 of the Bankruptcy Act. The full quotation is:

> "No credit will be allowed to Potts as compensation for his own time, or for fees to counsel or out-of-pocket expenses. The courts have repeatedly pointed out in interpreting Section [249 of the Bankruptcy Act], that trafficking in the securities of the debtor has been one of the most persistent evils in reorganization [citations omitted]. Potts gambled at his own risk. The gamble failed and he must foot the bill." 161 F.2d at 600.

III. Petitioners' Reliance Upon *Wolf* v. *Weinstein* and Other Cases Construing § 249 of the Bankruptcy Act, is Misplaced.

As we have noted, and as the Courts of Appeals have consistently recognized, there are situations where Congress has, by statute, limited the discretion of reorganization courts to grant fees and allowances. Section 249 of the Bankruptcy Act, 11 U.S.C. § 649, which precludes any allowance for fees or expenses to a reorganization fiduciary who has engaged in insider trading, is such a statute. *Wolf* v. *Weinstein,* 372 U.S. 633 (1963), deals with the definition of the scope of that statute, specifically, whether responsible managing employees are fiduciaries within the meaning of § 249.* This Court held that they were, and therefore were subject to § 249's absolute prohibition. In light of its decision as to the reach of the statute, the Court found no room to apply traditional equitable principles in mitigation, such as the *de minimis* rule and the power of the chancellor to limit the forfeiture to future payments. *Wolf* v. *Weinstein, supra,* 372 U.S. at 654-55.**

Petitioner's reliance upon *Wolf* and other § 249 cases, e.g., *In re Midland United Co., supra; Young* v. *Potts, supra,* is misplaced. No one contends that § 249 applies here. The Second Circuit properly rejected Petitioner's efforts to synthesize from this Court's decisions in *Woods* and *Wolf* a single doctrine barring all fees and allowances. It stated "we believe that *Wolf* bears only marginally, if

---

* Section 249 is a companion statute to Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78 p(b). See *Wolf* v. *Weinstein, supra,* 372 U.S. at 643, fn. 11.

** Petitioner refers to this passage (Pet. 18, 24), but fails to recognize that this Court's discussion relates to the *statutory* penalty. The sentence he quotes is followed by this statement: "Thus the policies of the statute afford no alternative but to order the restitution of all amounts. . . ." 372 U.S. at 654.

at all, on the question presented by the instant appeal" (App. 21a-22a).*

While *In re Inland Gas Corp.*, 309 F.2d 176 (6th Cir. 1962), cited by Petitioner (Pet. 26-27), invokes, as Petitioner avers, a rule of "strict enforcement", it is a rule of "strict enforcement of the Section 249, although often resulting in an obvious financial hardship, [which] is necessary in order to discourage and eliminate"

> "trafficking in the securities of the debtor [,] . . . one of the most persistent evils in reorganization which Congress attempted to eliminate in its enactment of Section 249 of the [Bankruptcy] Act, [citing *Young* v. *Potts, supra,* and *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea,* 266 F.2d 862 (2d Cir.), *cert. denied,* 361 U. S. 862 (1959)]." 309 F.2d at 181.

Thus, contrary to Petitioner's assertion, there is no broad *Wolf-Woods* synthesis which precludes compensation and reimbursement on the facts of this case, but rather a general recognition of the equitable discretion of the reorganization court, subject to specific statutory exceptions.

---

* Petitioner's reliance (Pet. 25, 26) on *Mosser* v. *Darrow,* 341 U.S. 267 (1951), is also misplaced. He ignores the fact that *Mosser* was not an allowance case but a self-dealing case. The Court held in *Mosser* that a bankruptcy trustee—who had authorized and failed to disclose a conflict of interest between his employees and the bankrupts—could be surcharged for the employees' profits. The trustee employed two assistants in managing bankrupt holding companies on terms which permitted those employees to trade for their own profit in the securities of the companies at the same time as the trustee was purchasing them. The trustee made no disclosure of this agreement. "Indeed, it appears that he did not even disclose this feature of the transaction to his own counsel." 341 U.S. at 274. The *Mosser* case clearly does not require the unfair result which Petitioner asks this Court to impose.

Conclusion

The decision of the court below, affirming the decision of the Reorganization Court so far as appealed from, is correct and does not present an issue warranting review by this Court. There has been no showing of any conflict between the decision below and that of other circuits or of this Court. No question of general federal reorganization or bankruptcy policy is involved. The petition should be denied.

Respectfully submitted,

WHITNEY NORTH SEYMOUR
Counsel for Respondent
Manufacturers Hanover Trust Company
One Battery Park Plaza
New York, New York 10004

ALBERT X. BADER, JR.
WILLIAM K. BLOMQUIST
SIMPSON THACHER & BARTLETT,
Of Counsel.

No. 76-1794

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1976

In the Matter of
THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, DEBTOR

JACOB D. ZELDES, Successor Indenture Trustee under The New York, New Haven and Hartford Railroad Company's General Income Mortgage Dated as of July 1, 1947,
Petitioner

v.

MANUFACTURERS HANOVER TRUST COMPANY, Former Indenture Trustee under The New York, New Haven and Hartford Railroad Company's First and Refunding Mortgage Dated as of July 1, 1947; and

RICHARD JOYCE SMITH, Trustee of the Property of The New York, New Haven and Hartford Railroad Company, Debtor,
Respondents.

BRIEF OF RICHARD JOYCE SMITH, TRUSTEE OF THE PROPERTY OF THE DEBTOR, IN OPPOSITION TO CERTIORARI

JOSEPH AUERBACH
MORRIS RAKER
100 Federal Street
Boston, Massachusetts 02110

Of Counsel

JAMES WM. MOORE
54 Meadow Street
New Haven, Connecticut
06506

Attorney for Respondent
Richard Joyce Smith, Trustee

July 15, 1977

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1976

No. 76-1794

In the Matter of
THE NEW YORK, NEW HAVEN AND
HARTFORD RAILROAD COMPANY,
DEBTOR

JACOB D. ZELDES, Successor Indenture Trustee under The New York, New Haven and Hartford Railroad Company's General Income Mortgage Dated as of July 1, 1947,
Petitioner,

v.

MANUFACTURERS HANOVER TRUST COMPANY, Former Indenture Trustee under The New York, New Haven and Hartford Railroad Company's First and Refunding Mortgage Dated as of July 1, 1947; and

RICHARD JOYCE SMITH, Trustee of the Property of The New York, New Haven and Hartford Railroad Company, Debtor,
Respondents.

BRIEF OF RICHARD JOYCE SMITH, TRUSTEE OF THE PROPERTY OF THE DEBTOR, IN OPPOSITION TO CERTIORARI

STATUTE PRIMARILY INVOLVED

Section 77(c)(12) of the Bankruptcy Act, 11 U.S.C. § 205(c)(12)(1970), in the form set out by Petitioner (Petition at 3) was amended, effective as to these proceedings on February 5, 1976.

The amendment to § 77(c)(12) was effected by § 618(b) of the Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210 (Feb. 5, 1976), which, in pertinent part, provides:

> The powers and duties of the Commission under section 77 of the Bankruptcy Act (11 U.S.C. 205), with respect to a railroad in reorganization in the region which conveys all or substantially all of its designated rail properties to the [Consolidated Rail] Corporation or a subsidiary thereof, or to profitable railroads in the region, pursuant to the final system plan, and the requirement that plans of reorganization be filed with the Commission, shall cease upon the date of such conveyance. The powers and duties of the Commission under section 77 of the Bankruptcy Act shall also so terminate, as of the date of enactment of this paragraph, with respect to any railroad in reorganization under such section 77 but not subject to this Act which (1) does not operate any line of railroad, and (2) has transferred all or substantially all of its rail properties to a railroad in reorganization in the region which was subject to this Act prior to the date of enactment of this paragraph. Thereafter, such powers and duties of the Commission shall be vested in the district court of the United States which has jurisdiction of the estate of any such railroad in reorganization at the time of such conveyance.

COUNTERSTATEMENT OF QUESTION PRESENTED

Did the Reorganization Court, as a court of equity, reasonably exercise its discretion, in light of its findings as to a conflict of interest and other matters, in conditionally awarding compensation to, and in reimbursing expenses of, the indenture trustee?

STATEMENT OF THE CASE

Manufacturers Trust Company (the "Trust Company") had been the Trustee under the indenture securing the First and Refunding Mortgage Bonds (the "NH Bonds") of The New York, New Haven and Hartford Railroad Company, Debtor (the "New Haven") from its execution in 1947. The Trust Company merged with the Hanover Bank ("Hanover") shortly before the New Haven entered reorganization in 1961 to form Manufacturers Hanover Trust Company ("Manufacturers"). Hanover had served as a trustee under mortgage indentures of The New York Central Railroad Company ("NY Central") since 1897. In particular, it had since that time been indenture trustee under the mortgage securing the NY Central's so-called Gold Bonds due 1997.

Manufacturers continued as indenture trustee for both the NH Bonds and the Gold Bonds. NY Central merged in 1968 with The Pennsylvania Railroad Company ("Pennsylvania") to form Penn Central Transportation Company ("Penn Central"),[1] and the Gold Bonds became a Penn Central obligation.

The New Haven has been in reorganization under § 77 of the Bankruptcy Act since July, 1961, and the NH Bonds have been in default since that time. Circuit Judge Robert P. Anderson has presided over the New Haven's reorganization in the United States District Court for the District of Connecticut ("Reorganization Court") since the inception of the reorganization, first as a district judge and since 1964 by designation. Respondent Richard Joyce Smith (the "New Haven Trustee") was one of three reorganization trustees originally appointed; since 1969 he has been the sole trustee.

Penn Central has been in reorganization under § 77 since June, 1970, and the Gold Bonds have been in default since that time.

---

[1] Immediately following the merger, the company was known as Pennsylvania New York Central Transportation Company; later, its name was changed to Penn Central Company and then to Penn Central Transportation Company.

As the profitability of rail operations in the East ebbed or ceased entirely, liens on non-rail properties mortgaged to secure railroad bonds became increasingly important. The security for the Gold Bonds includes mortgages of Penn Central's (originally NY Central's) interest in valuable commercial properties along Madison, Vanderbilt, Park and Lexington Avenues in the vicinity of New York's Grand Central Terminal (the "GCT Properties").

For over 100 years, the New Haven enjoyed contractual rights to enter New York City over NY Central's tracks and to share its terminal facilities. The New Haven participated with NY Central in the development and operation of the GCT Properties, with the net income being applied to reduce the costs of operating Grand Central Terminal.[2]

As a result of action taken by the New Haven Trustee, the Interstate Commerce Commission (the "ICC") conditioned its approval of the merger of NY Central and Pennsylvania on the New Haven's inclusion in its merged system.[3] Following the Court's affirmance of the merger, the New Haven carried out the inclusion, *i.e.* the conveyance of its properties to Penn Central, on December 31, 1968, although the consideration for the conveyance remained to be adjudged.

The inclusion constituted a first step in the New Haven's plan of reorganization under § 77. Formally, the New Haven's assets were conveyed to Penn Central free of lien, and, by order of the Reorganization Court, the lien of the NH Bonds attached to the consideration to be received from Penn Central. The second step in the plan provided for the treatment of claimants based on the consideration to be received from Penn Central. Through its counsel, Simpson, Thacher & Bartlett,

[2] It was not until the mid-1960's that the income from the GCT Properties exceeded the cost of operating the Terminal, thereby making significant the issue of New Haven's interest in the excess income.

[3] Pennsylvania RR.—Merger—New York Central RR., 327 I.C.C. 475 (1966); Penn Central Merger Case, 389 U.S. 486 (1968).

Manufacturers participated actively in the litigation with Penn Central over the price to be paid by Penn Central, including litigation over the nature and value of the New Haven's interest in the GCT Properties. Judge Anderson found that Manufacturers was among those to be credited, not only with increasing the purchase price, generally, above that fixed by the ICC, but also with securing a favorable judgment concerning the New Haven's rights in the GCT Properties.[4]

This valuation litigation culminated in the *New Haven Inclusion Cases*,[5] decided by the Court only eight days after Penn Central had itself filed for reorganization under § 77. In the subsequent proceedings on remand before the Reorganization Court, a principal issue was the nature of protection for the New Haven's rights against Penn Central in view of the latter's bankruptcy. It was pleaded and argued by the New Haven Trustee with the support of Manufacturers (and others) that an equitable lien should be declared to exist on those former New Haven properties transferred in fee, and that Penn Central should be deemed to hold the New Haven's former 50% interest in the GCT Properties in constructive trust for the benefit of the New Haven.

This position had the effect of being an indirect attack upon the priority and extent of the lien on the GCT Properties securing the Gold Bonds. Manufacturers then was faced with the involuntary dilemma and conflict of its respective indenture trusteeships for the NH Bonds and the Gold Bonds. In its capacity as trustee under the Gold Bond indenture, but through counsel other than Simpson, Thacher & Bartlett, Manufacturers joined with Penn Central's reorganization trustees in opposing the constructive trust and the New Haven's related claims against Penn Central. Manufacturers thus openly appeared before Judge Anderson on both sides of the same issues.

[4] *In re* New York, N.H. & H. RR., 421 F. Supp. 249, 269 (D. Conn. 1976).

[5] 399 U.S. 392 (June 29, 1970).

The constructive trust and the related relief sought by the New Haven Trustee, and supported by Manufacturers in its capacity as indenture trustee for the NH Bonds, were granted by Judge Anderson. However, the Court of Appeals for the Second Circuit in an appeal taken by the Penn Central reorganization trustees, with the support of Manufacturers in its capacity as indenture trustee for the Gold Bonds, reversed on jurisdictional grounds.[6]

Manufacturers filed a petition with Judge Anderson on June 21, 1971, to resign as indenture trustee of the NH Bonds, after having sought futilely since mid-1970 to find a trust company willing to act as indenture trustee. It proved impossible to find a corporate trustee and Judge Anderson appointed an individual. Manufacturers filed a petition with the Penn Central reorganization court on July 17, 1975, resigning as trustee under the Gold Bonds.

The question of the impact of its dual role arose in the case at bar in connection with a petition filed by Manufacturers under § 77(c)(12) of the Bankruptcy Act with the Reorganization Court for expense reimbursement and compensation from the New Haven estate.[7] In a statement of position which he then filed with the Reorganization Court, the New Haven Trustee raised the issue of Manufacturers' conflict, and took the position that the Reorganization Court had discretion whether and to what extent Manufacturers should be censured through

[6] The merits of these issues remain to be determined.

[7] The Railroad Revitalization and Regulatory Reform Act of 1976 withdrew the ICC's jurisdiction under § 77 relating to the New Haven's reorganization, effective February 5, 1976.

The proceedings before the Reorganization Court took place in May and June of 1976. Initially, the ICC had agreed that it had no jurisdiction over Manufacturers' petition in light of the recent legislation. Following entry of the Reorganization Court's judgment, the ICC changed its position and appealed to the Court of Appeals for the Second Circuit on the ground that the withdrawal of jurisdiction was prospective only. However, before the case was heard by the Second Circuit, the ICC again reversed its position and withdrew the appeal.

a determination of allowances. The New Haven Trustee pointed out that, in large measure, the fee sought by Manufacturers was to be passed through to its counsel, Simpson, Thacher & Bartlett, who had acted in a wholly professional manner in the premises, free from any conflict.

Judge Anderson found that Manufacturers had acted under a conflict. He determined that the allowance to Manufacturers should reflect this finding, but should also take into account the valuable services provided by Manufacturers and Simpson, Thacher & Bartlett during the period from 1961 to 1970. Thus, he made an award to Manufacturers in respect of legal fees that was consistent with the uncontroverted view that Simpson, Thacher & Bartlett should not be penalized, and reimbursed Manufacturers for other out-of-pocket expenses, but postponed compensation to Manufacturers for its own services pending a determination of whether its conflicted activities indeed injured the New Haven estate. This ultimate determination would be accomplished through a formula which would limit Manufacturers' allowances to a percentage (a maximum of ¼ of 1%) of future payments received by New Haven from Penn Central.[8]

Petitioner herein, himself a successor indenture trustee, together with Lawrence W. Iannotti, successor indenture trustee to Manufacturers, appealed to the Court of Appeals for the Second Circuit.

The Second Circuit, by a unanimous opinion and decision affirmed the Reorganization Court.

The Court of Appeals observed at the outset of its opinion, that:

> This is the case of the wise and comprehending chancellor. (Appendix to Petition at 3a)

[8] The amount of future payments is the subject of a settlement between the New Haven Trustee and the Penn Central Trustees which is incorporated in a plan of reorganization for Penn Central which is now sub judice.

ARGUMENT

Petitioner relies on apparently alternative arguments in seeking to have the Court grant certiorari. First, he argues that the decision below is in conflict with existing law. Second, he argues that this matter warrants decision by the Court in order to establish the law in what he contends is an important area of wide applicability.

Contrary to these arguments, the New Haven Trustee submits that the decision below neither fails to follow decisions of the Court nor conflicts with decisions of other Courts of Appeals and, in any event, is so totally the product of a complex and unique factual situation that it cannot be deemed to have decided a question of law so important that it should now be determined by the Court. Moreover, the New Haven Trustee is both satisfied with the fairness and equity of the decision below and concerned that the plenary review sought by Petitioner exposes the New Haven estate to the burden of costs of both sides from unnecessary and expensive further appellate proceedings.

I. The Decision Below Does Not Conflict with Prior Decisions of This or Other Courts.

Petitioner cites a number of decisions by Courts of Appeals other than the Second Circuit that are alleged to be in conflict with the decision below.[9] To be sure, these cases reach decisions which are different from that reached in this case, but they do so based either on readily distinguishable factual grounds or on an inapposite statutory requirement. Cases[10] decided under § 249 of the Bankruptcy Act, 11 U.S.C. § 649, which absolutely bars compensation to fiduciaries in a Chapter X proceeding who have traded in the debtor's securities, a matter not in issue here, are not relevant to the instant issue.

---

[9] With limited exception, these cases were not cited to the Court of Appeals below.

[10] Wolf v. Weinstein, 372 U.S. 633 (1963); *In re* Inland Gas Corp., 309 F. 2d 176 (6th Cir. 1962); *In re* Walchef Development Corp., 388 F. Supp. 1064 (S.D. Cal. 1975).

The cases cited by Petitioner do not support any conflict in decisions as alleged by him. Petitioner's position, it appears, is founded solely on his hypothesis that *Woods v. City National Bank and Trust Co.*, 312 U.S. 262 (1941), established an "inflexible rule of equity" (Petition at 14), which absolutely prohibits an allowance of compensation to a fiduciary involved in a conflict of interest, no matter what the extenuating circumstances.

In *Holmberg v. Armbrecht*, 327 U.S. 392 (1946), the Court stated that "[e]quity eschews mechanical rules; it depends on flexibility." *Id.* at 396. Although that was not stated in the context of a conflict of interest, the underlying principle is applicable to this case.

The lack of flexibility in certain areas of jurisprudence was, of course, the key factor in the evolution of courts of chancery. The Court of Appeals obviously construed this case itself to be a testimonial for preserving flexibility, referring to "the wise and comprehending chancellor." And, indeed, Petitioner himself agrees with that characterization. (Petition at 19).

Notwithstanding that agreement, however, Petitioner contends that the *Woods* case withdrew from Judge Anderson the discretion to view Manufacturers' fee request in the context, *inter alia*, of the substantial benefit which Manufacturers had conferred on the New Haven estate prior to 1970, the extraordinary and involuntary nature of the conflict, the primary role played by the Penn Central trustees in opposing the New Haven interests, and Manufacturers' attempt to avoid leaving any bondholders without an indenture trustee and to insulate its decision-making process from the conflict.

Judge Anderson has sat in these proceedings since the New Haven entered reorganization in 1961 and has first-hand, actual knowledge of the relevant facts bearing on Manufacturers' conflict and conduct. Petitioner contends that, sitting as a court of equity, Judge Anderson was nevertheless bound by the *Woods* case to eschew what he considered to be the equitable result, and inflexibly to deny any compensation and expense reimbursement.

Unless the Court agrees with Petitioner's hypothesis that the *Woods* case requires inflexibility, the decision below neither conflicts with prior decisions of this Court nor with the decisions of other Courts of Appeals.

II. The Decision Below is Based on a Unique Factual Situation.

Petitioner argues that the decision below "will set [a] dangerous precedent for railroad reorganizations and all bankruptcy law." (Petition at 15). It is submitted that, on the contrary, the unique factual background of this case makes it essentially sui generis. It is difficult to believe that it should now be assumed that there will ever be another case like it.

Given the limitations on the obligations and responsibilities of trustees under mortgage indentures, a conflict of the nature herein could again arise only in a situation where: (1) two otherwise unrelated issuers have an interest in the same piece of property and each company secures its public issue of securities with a mortgage lien on its interest in the property; (2) both companies default in their obligations secured by such mortgages; (3) a conflict develops between the two companies over their respective interests in the subject property; (4) the event giving rise to an active conflict shall not have occurred until after both companies had defaulted; and (5) the indenture trustee finds it impossible to secure a successor trustee for one of the mortgages in a timely fashion. In short, the considerations with which Judge Anderson was faced will not be repeated unless the same person, as indenture trustee for two different companies, becomes engaged in litigation over conflicting security interests in the same property in a situation where the conflict could not reasonably have been anticipated until both obligors became bankrupt. While history may repeat itself, that possibility is sufficiently remote that the immediate need for the Court to establish the "standards" referred to by Petitioner (Petition at 15) is without adequate support.

III. Further Appellate Proceedings are Not in the Interest of the New Haven Estate.

It was the New Haven Trustee who first raised the issue of Manufacturers' conflict and its appropriate treatment in the allowance of compensation. He did so in his reorganization trustee's capacity as a fiduciary for all creditors of the estate, with a view toward assuring fair and equitable treatment for all persons having an equity in the estate's limited assets. The New Haven Trustee considers that Judge Anderson's determination achieves that goal and submits in support that the panel of the Court of Appeals unanimously agreed with the Reorganization Court's analysis of the applicable legal principles. Further appellate review is unnecessary to protect any interest in the estate, and would burden the most junior interest in the estate with additional costs.

Petitioner claims that Manufacturers' fees would diminish "the funds available to meet the New Haven estate's obligations to the holders of its general income bonds" for whom Petitioner is indenture trustee. (Petition at 21 n.10). Like payment of any other administration charge, that is true. But such an effect does not diminish equity's concern whether direct beneficiaries of an increase in the estate, achieved in significant part by Manufacturers, should be allowed to avoid an appropriate allowance of fees. That Manufacturers' efforts in the litigation over the New Haven's interest in the GCT Properties may be a key to the existence of any equity for the general income bonds should, in view of its conflict, not necessarily produce compensation for Manufacturers, but, conversely, the existence of a conflict should not bar a court of equity from a determination that expense reimbursement and compensation may be warranted notwithstanding the conflict.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

JOSEPH AUERBACH
MORRIS RAKER
100 Federal Street
Boston, Massachusetts 02110

Of Counsel

JAMES WM. MOORE
54 Meadow Street
New Haven, Connecticut
06506

Attorney for Respondent
Richard Joyce Smith, Trustee